

45289

Lao PDR

**PUBLIC EXPENDITURE TRACKING SURVEY  
IN PRIMARY EDUCATION AND PRIMARY HEALTH**

**MAKING SERVICES REACH POOR PEOPLE**

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**ACRONYMS AND ABBREVIATIONS**

COA	Chart of Accounts
CPI	Committee for Planning and Investment
DEB	District Education Bureaus
DFO	District Finance Offices
DHO	District Health Offices
DOPC	Department of Planning and Cooperation
EFA	Education For All
FY	Fiscal Year
GDP	Gross Domestic Product
GOL	Government of the Lao People's Democratic Republic
HC	Health Centers
Lao PDR	Lao People's Democratic Republic
LECS	Lao PDR Expenditure and Consumption Survey
MDGs	Millennium Development Goals
MOE	Ministry of Education
MOF	Ministry of Finance
MOH	Ministry of Health
NA	National Assembly
NGO	Non-Governmental Organization
NGPES	National Growth and Poverty Eradication Strategy
NSC	National Statistics Centre of the Lao PDR
NSEDP	National Socio-Economic Development Plan
PA	Poverty Assessment
PEMSP	Public Expenditure Management Strengthening Program
PER	Public Expenditure Review
PES	Provincial Education Services
PETS	Public Expenditure Tracking Survey
PFO	Provincial Finance Offices
PHO	Provincial Health Offices
PRSC	Poverty Reduction Support Credit
PRSO	Poverty Reduction Support Operations
PSIA	Poverty and Social Impact Analysis
RDF	Revolving Drug Funds
USD	US Dollar

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# TABLE OF CONTENTS

EXECUTIVE SUMMARY .....	i
Achievements and challenges .....	ii
Key constraints to service delivery .....	iii
Frontline services: access and quality fall short .....	iv
Way Forward.....	vi
INTRODUCTION.....	1
The Purpose of the Report.....	1
Education and Health Sector Context .....	3
The highly decentralized fiscal system .....	4
Accountability–Long- and Short-Route Relationships .....	7
Public Expenditure Tracking Survey–Design, Methodology and Limits .....	9
Conclusions .....	14
EDUCATION.....	15
Outcomes .....	15
Public Funding .....	17
Expenditures Management.....	20
Budget Preparation .....	20
Execution and Reporting .....	26
Frontline Services .....	28
Teachers.....	29
Operating funds and school quality .....	41
Accountability.....	48
Conclusions .....	50
HEALTH .....	52
Outcomes .....	52
Public Funding .....	55
Expenditures Management.....	59
Budget Preparation .....	59
Execution and Reporting .....	64
Frontline Services .....	66
Health workers.....	66
Resource flows and Revolving Drug Funds .....	71
Operating funds and health center quality .....	75
Accountability.....	79
Conclusions .....	79
FINDINGS AND RECOMMENDATIONS .....	81
Main findings of PETS .....	82
Finance Management .....	83
Public Finance Management.....	83
Budget Law Implementation .....	84
External Financing Management .....	86
Bolster Public Expenditure Management Strengthening Program .....	86
Steps forwards.....	88
Conclusions.....	90
REFERENCES .....	91

## FIGURES

Figure 1: Lao PDR's subnational authorities account for almost one-half of total government spending, a large share by East Asian standards .....	5
Figure 2: The framework of accountability relationships .....	8
Figure 3: District-Level Map of the PETS Survey .....	11
Figure 4: There are large disparities in education outcomes .....	16
Figure 5: Poor parents/students have little clout with policymakers .....	17
Figure 6: Lao PDR stands out in international comparison for its low spending on education. ...	18
Figure 7: While public educational expenditures have increased since the late 1990s, it still remains below levels from the mid 1990s. ....	18
Figure 8: As education spending has shifted away from primary education, it puts poor people at a further disadvantage. ....	19
Figure 9: Policymakers may not be able to ensure schools deliver efficient services. ....	20
Figure 10: While all PES receive government funds, surplus provinces are more likely to obtain donor funding and deficit provinces are more likely to rely on community contributions. ....	22
Figure 11: Reliance on foreign funding and a lack of domestic funds are associated with insufficient recurrent spending. ....	23
Figure 12: The share of capital spending as a percentage of total education spending varies by year and by province. ....	23
Figure 13: Due to the small budget envelope for recurrent education spending, the rise in the share for salaries has squeezed operating expenditures.....	24
Figure 14: The share of non-wage spending as a percentage of total recurrent education spending varies widely across provinces. ....	25
Figure 15: Schools in less well-off areas participate less in budget preparations. ....	26
Figure 16: DFO in non-priority districts are better equipped than those in priority districts. ....	28
Figure 17: The accountability of schools to policymakers and parents is crucial for education. ...	29
Figure 18: More than nine out of 10 teachers are quota teachers. ....	30
Figure 19: Salaries vary little in nominal terms; they are higher in less well-off areas in real terms. ....	31
Figure 20: Salary payment delays are more serious outside of cities; most teachers have experienced salaries arrears in the past. ....	33
Figure 21: Differences in teachers' salary payment are small between reported by DEB and schools .....	35
Figure 22: Funding shortage in DEB and DFO creates a bottleneck that leads to salary delays. .	37
Figure 23: In spite of the difficult circumstances, teachers like their work and became teachers for the right reasons.....	38
Figure 24: Teachers are dedicated to improve education service.....	38
Figure 25: Most school directors and teachers are local or know the local language. ....	39
Figure 26: Teachers' absenteeism rates do not appear to be high. ....	40
Figure 27: About two out of five teachers who were absent from work were absent for reasons other than official reasons or sickness. ....	40
Figure 28: Teachers in urban, non-poor, and Lao-Tai areas are more likely to hold multiple jobs. ....	41
Figure 29: Most schools receive funding from parents and communities.....	41
Figure 30: Schools in well-off areas can mobilize more resources than schools in less well-off areas.....	42
Figure 31: Three out of four schools collect tuition/registration fees. ....	42
Figure 32: In over two out of three cases, parents are in charge of setting tuition fees. ....	43
Figure 33: Tuition fees are higher per student in well-off areas.....	43

Figure 34: Schools in priority districts have worse infrastructure.....	44
Figure 35: Many students cannot afford textbooks. ....	45
Figure 36: Non-Lao-Tai villages have fewer textbooks than other villages. ....	45
Figure 37: Teachers and school directors in well-off areas are better educated and more experienced.....	46
Figure 38: Multi-grade classes are common in less well-off areas. ....	47
Figure 39: Teachers spend on average 45 minutes to prepare for each class. ....	47
Figure 40: Student-to-teacher ratios are higher in less well-off areas than in well-off areas. ....	48
Figure 41: More school directors meet with parents on a weekly basis than with officials from DEB. ....	49
Figure 42: More children are kept out of school for reasons other than tuition/registration fees. ....	50
Figure 43: Poor people have poorer health outcomes. ....	54
Figure 44: Overall per capita health expenditures are increasing, but they started at a low level. ....	56
Figure 45: Public health expenditures as a percent of GDP in Lao PDR are low compared to other low income countries.....	57
Figure 46: Concentration curves of consumption and health care subsidy by health provider and inpatient/outpatient care .....	58
Figure 47: Poor patients have little clout with policymakers on budget decisions. ....	59
Figure 48: Policymakers may not be able to ensure health centers deliver efficient service. ....	59
Figure 49: Actual health spending compared to planned health spending is lower in deficit provinces. ....	61
Figure 50: Health capital spending varies across provinces and by year. ....	62
Figure 51: Health non-wage spending varies across provinces.....	63
Figure 52: Health recurrent expenditures per capita vary across provinces. ....	63
Figure 53: DHO in non-priority districts have better office facilities. ....	65
Figure 54: Accountability of Health Centers to policymakers and patients is crucial for health service delivery.....	66
Figure 55: HC workers' salaries vary little in nominal terms; they are higher in rural areas in real terms. ....	67
Figure 56: Health workers in health centers get paid less frequently than they are supposed to. ....	68
Figure 57: One out of three health workers had outstanding balances due for their salaries and overtime at the time of the survey. ....	68
Figure 58: Overall difference in salary payments reported by DHO and HC is small, but some areas have greater discrepancies.....	69
Figure 59: Delays in revenue collection at DFO are the primary reason for salaries being in arrears. ....	70
Figure 60: Less than one out of five health workers are absent from work, just two out of five are absent without a legitimate reason. ....	71
Figure 61: Less than 20 percent DHO received financial supports from PHO .....	72
Figure 62: Donors and NGOs are the main financiers of renovation costs for HC.....	73
Figure 63: Health centers in poor, rural, or non Lao-Tai areas are more likely to rely on off-budget funding.....	73
Figure 64: RDF profit ratios cluster around 25 percent, but they differ across provinces. ....	74
Figure 65: Health centers in non-poor, urban, and Lao-Tai areas are better equipped than those in poor, rural, and non Lao-Tai areas. ....	76
Figure 66: The poor have less access to health care, less access to safe water, and less access to local hospitals. ....	77
Figure 67: People in less well-off areas spend a lower share of household consumption on health although their household consumption is already low. ....	78
Figure 68: HC health workers in poor rural areas are less experienced. ....	78

## TABLES

Table 1: PETS Timeline .....	9
Table 2: Modules of the PETS Questionnaire .....	11
Table 3: Analytic Domains.....	12

## BOXES

Box 1: Education and Health—a Public Responsibility .....	2
Box 2: Central-Local Relationships .....	6
Box 3: Subnational Administration .....	7
Box 4: Budget Process in the Education Sector .....	21
Box 5: Why Poor People Have Poor Health.....	53
Box 6: Budget process in the Health Sector .....	60
Box 7: Revolving Drug Funds.....	74
Box 8: Public Expenditures in Priority Districts .....	84
Box 9: New Organic Budget Law in Lao PDR—Changes in Intergovernmental Fiscal Relations	85



## EXECUTIVE SUMMARY

**Lao People's Democratic Republic (Lao PDR) has come a long way since launching its economic reforms two decades ago.** The country can take pride in its solid track record of delivering basic services and improvements in social indicators. Primary education and health outcomes in Lao PDR have improved in the past decade. In spite of these achievements, Lao PDR remains one of the poorest countries in East Asia with some of the worst social outcomes. In order to improve upon present conditions, Lao PDR has set itself the goal of graduating from its status as a least developed country by 2020. The Government of Lao (GOL) has articulated a bold social strategy in the 6th National Socio-Economic Development Plan (NSED) for 2006 to 2010. This plan puts improving service delivery at the center of its agenda.

**To improve the effectiveness of public spending on education and health, it is important to understand how resources flow from the center through layers of subnational authorities, then what factors affect frontline services.** Even though there are many well-functioning social facilities in the country, lack of information makes it difficult to learn what works and what does not work, to draw clear lessons, and to improve policies. Closing part of this knowledge gap with information about current public expenditure management practices in the education and health sectors at the district and facility levels was the motivation for this Lao PDR Public Expenditure Tracking Survey (PETS). The report looks at how public financial resources, human resources, and budget processes combined to deliver services at the facility level for students and patients in Lao PDR. Its objectives are to: (a) analyze management practices relevant to current public expenditures, then advise Lao PDR about how to improve basic service delivery in education and health; and (b) serve as an independent monitoring tool to assist government in improving accountability. PETS links downstream with the analysis from the Lao PDR Poverty Assessment (World Bank, 2006a) on education and health outcomes at the household level, and upstream with the analysis from the Lao PDR Public Expenditure Review (World Bank, 2006b) on public expenditures at the national and subnational levels.

**The report presents a snapshot of financial flows and human resources at the provincial, district, and facility levels.** It aims to complement and test some of the findings from Public Expenditure Review and Poverty Assessment mainly at the district and facility levels. PETS tracks salary payments from districts to facilities by comparing salary records of individual teachers and health workers; this is a first for Lao PDR. It also offers information about the timeliness of salary payments and correlates performance indicators with service delivery. The survey results show reasonable frontline service in Lao PDR, given tight budget constraints in the education and health sectors. Among the positives: (1) teachers' and health workers' job morale is high; (2)

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teachers' and health workers' absenteeism is low and ghost-workers are rare; (3) salary leakages from the district to the facilities are limited; and (4) parents/patients and community participation is active. However, challenges remain: (1) education and health services are poor in Lao PDR; there is considerable variation between surplus provinces and deficit provinces, between priority districts and non-priority districts, between cities and villages, between non-poor and poor areas, and between localities with a high concentration of Lao-Tai and elsewhere; (2) the three major contributors to the overall low level of primary education and health service delivery are insufficient resources, inefficient allocation of funds, and weak expenditure management; and (3) effectively delivering services to poor people requires better targeting and improved management of public expenditures.

**This executive summary:** (1) reviews achievements and challenges in the education and health sectors; (2) examines key constraints on service delivery; (3) explains why frontline services fall short on access and quality; and (4) offers recommendations for the way forward.

## **Achievements and challenges**

**In the last decade Lao PDR has made improvements in primary education and health.** According to the 1995 and 2005 Population Censuses and the 1992/93 and 2002/03 Lao PDR Expenditure and Consumption Surveys (LECS), the achievements in education and health have made a positive difference in the lives of many citizens.

**Primary education and health service delivery in Lao PDR is reasonably good, given the limited resources available.**

- School teachers/health workers are satisfied with their jobs; morale is high.
- Teachers'/health workers' absenteeism is low; ghost-teachers or ghost-health workers are rare.
- Salary leakages from the district to the facilities are limited.
- Parents / patients and the community actively participate in frontline services.

**However, achieving the MDGs and the national development objectives on education and health will not be easy.** Education and health outcomes in Lao PDR are low compared with East Asian standards. Adult literacy rate is 69 percent and life expectancy at birth is 61 years in Lao PDR; while average levels in East Asia are 91 percent and 71 years respectively. Within the country, there are also gaps in service that highlight differences between cities and villages, non-poor and poor areas, Lao-Tai concentrated localities and elsewhere.

## **Key constraints to service delivery**

**In Lao PDR, low public funding, inefficient allocation of resources, and weak management of expenditures are key constraints to primary education and health service delivery.** The findings from PETS and those from the Public Expenditure Review (PER) reinforce each other.

### *Low Public Funding*

**Based on international comparisons, Lao PDR is unusual for the scant resources it allocates to education and health.** In 2004/05, total public expenditures for education were 2.3 percent of GDP; domestic outlays were just 1.1 percent; education's share of overall government spending was about 11 percent. As a result, the education system has to operate very frugally. In Lao PDR the unit spending per student in primary school is just two percent of GDP per capita, compared to seven to 14 percent in many developing countries (World Bank, 2006b). In 2002/03, public health spending was 1.2 percent of GDP; as a share of overall government spending, it was about five percent. Total public and private expenditures for health were 8.7 USD per capita in 2002. That figure puts Lao PDR at the very low end of the spectrum compared with other countries. For example, low income countries spend an average of 29 USD per capita compared to East Asian countries which spend an average of 64 USD per capita.

**Given limited public spending, it is not surprising that insufficiency of resources was the single most pressing problem facing the education and health sectors.** The majority of PES, DEB, PHO, and DHO consider insufficient resources as the reason for budget cuts. Education and health departments in deficit provinces and priority districts often face even stiffer adjustments. Nine out of 10 schools and health centers have to rely on off-budget resources from donors, NGOs, parents/patients and communities to cover their operating costs. Three out of four schools collect tuition/registration fees. The profits from Revolving Drug Funds (RDF) serve as an important source of revenue for health centers to cover the cost of their office supplies, transportation, and utilities.

### *Inefficient and inequitable allocation of funds*

**A large part of public spending for education and health, limited as it is, goes for capital expenditures.** In Lao PDR during 2003/04 and 2004/05, less than half of the national education and health budgets went for recurrent expenditures, such as wages and operating costs. This imbalance leads to delays in the payment of salaries and an acute shortage of funds for routine operating expenses. It also results in poor education and health services. For example, schools get built, but the supply of teachers and materials is inadequate; hospitals have beds, but the staffing and training of medical personnel are insufficient to the need.

**Public education and health spending gets diverted from the people who need it most.** A shift in funding to secondary schools and above has put a dent in the share of funds for primary education. Only about one-sixth of public education spending accrues

to the poorest quintile of the population. Likewise, much of government spending for health favors the central level; public subsidies to central hospitals are heavily biased in favor of the non-poor. The richest quintile captures more than one-fourth of public subsidies for health services compared with one-eighth for the poorest quintile. Just one-fifth of total public health expenditures went to district health facilities and village health centers, which primarily serve the poor.

### *Weak expenditure management*

**Weakness in expenditure management reduces the effectiveness of public spending on education and health service delivery.** In Lao PDR, the budget is a weak planning tool for several reasons. First, budget preparation suffers from a lack of realism. Expenditures are inflated and there is a lack of follow-through because of insufficient funds. Second, the process is compromised by off-budget funds; as a result, budget allocations do not reflect actual expenditures. Third, a lack of integration leads to a mismatch of capital and recurrent spending. Fourth, schools, health centers and districts usually do not have a role in budget preparations. Fifth, budget preparation runs from May to September; this compressed budget-cycle pays short shrift to budget planning and leaves little time for input from the districts and provinces or for a dialogue among the MOF, MOE, MOH, and the provinces. Budget details are often not final until four months after the fiscal year starts in October.

**Problems with expenditure management are compounded by weaknesses in budget execution, reporting, and capacity.** Until 2005, treasury reports were submitted almost entirely on paper. The lack of automation and agreement on a reporting format makes it difficult to generate regular, timely, and accurate reports that can serve as a check on budget execution. Moreover, capacity is low at the provincial and district levels.

**In a highly decentralized context, the central government of Lao PDR has limited control over the finance department.** Systematic links are weak between provincial finance departments and the Ministry of Finance. In Lao PDR, budget allocations depend on negotiations between provincial governors and the centre—not explicit rules. The treasury offices at the provincial and district levels lack authority. In case of a funding shortfall, PES and PHO are more likely to turn to provincial government than to Provincial Financial Offices (PFO). Provinces that collect tax revenues negotiate how much tax revenue they will remit to the central government and how much they will retain. Provincial authorities have the power to transfer funds within and across expenditure items; they also have the power to determine spending at the sectoral level. As a result of this discretionary power by the provincial governors, there is a disparity in resource allocation between provinces and a lack of alignment with national priorities.

## **Frontline services: access and quality fall short**

**Low public funding, inefficient and inequitable allocation of funds, and weak management of expenditures have had the following negative effects:** low salaries and frequent delays in payment, inadequate access to schools and health centers with

reasonable equipment, and teachers and health workers who receive short shrift on training.

### *Low salaries and payment delays*

**In Lao PDR, teachers'/health workers' salaries are very low.** The average monthly salary for teachers, including base salary, bonus, and allowance is about 390,000 kips or 39 USD. Of that, about 320,000 kips represents the base salary. For health workers, it is about 450,000 kips or 45 USD; of that, about 350,000 kips is base salary. Teachers' and health workers' salaries represent 130 percent and 150 percent GDP per capita, respectively; these salaries are very low compared with international standards. Teachers'/health workers' salaries are all based on the same payment scale; as a result, there is little variation across cities and villages. However, in real terms, purchasing power is higher in less well-off areas because living expenses are lower there. Central government budget is supposed to cover teachers'/health workers' salaries. PFO transfers resources to cover teachers' and health workers' salaries to DFO, which then transfers the resources to DEB and DHO. DEB and DHO actually deliver salary payments to schools and health centers for teachers and health workers, respectively. More than 90 percent of teachers and health workers surveyed reported that their salary is inadequate to cover minimum household living expenses. Most teachers and health workers have to hold multiple jobs, usually in agriculture. Some reported they have to borrow money occasionally to make ends meet.

**Frequent payment delays make low salaries even less appealing, especially in rural areas.** Throughout the country, fewer than one out of two teachers get paid timely every month; nearly two out of every five teachers gets paid irregularly. Seventy percent of teachers in urban areas get paid on time every month compared with 30 percent of teachers in rural areas. Throughout the country, only one out of two health workers gets paid on time every month; one out of three receives a salary every three months; and about one out of eight gets paid irregularly. Between October 2004 and September 2005, two out of three health workers reported delays in salary payments; at the time of the survey about one out of three health workers had an outstanding balance that was due. In urban areas during this same period, one out of four health workers had their salaries in arrears; the number was even higher in rural areas—up to two out of five. Delays in tax collection and in money transfers from upper layers of authorities are among major reasons for delays in salary payment.

**Low salaries and frequent delays in payments negatively affect the delivery of education and health services.** Inadequate and irregular salary payments are a major cause of concern for teachers and health workers. Teachers and health workers like to contribute to the community development and they have high job morale. Nevertheless, teachers who experience long and frequent payment delays are more likely to spend less time on lesson preparations and to be absent from work for unofficial reasons. Likewise, low-paid health workers tend to spend less time at work when their salary is in arrears

### *Schools and health centers: short on access and equipment*

**Students and patients lack access to primary schools and health centers.** According to LECS 2002/03, one out of six families had to send their children to neighboring villages for education. According to the Lao Population Census (2005), only four out of five villages have primary schools. Because of the lack of teachers, low student enrollment, and limited facilities, many primary schools are incomplete; they only have the first two or three grades. Nationally, only about three out of four households have access to skilled medical personnel at a dispensary; in Luang Namtha and Bokeo, the number is one out of three and two out of five, respectively (World Bank, 2004). Poor people are more likely to rely on self-healing or self-medication when they are sick compared with the non-poor for two reasons. The poor cannot afford to pay for health services and they may think the quality of care they have access to is not worth paying for.

**Most schools and health centers are poorly equipped.** The disparities are especially pronounced between priority and non-priority districts, and urban and rural areas. Many schools and health centers do not have basic facilities. For example, schools have an inadequate supply of student textbooks; health centers a dearth of medical laboratories.

*Teachers and health workers: short on training and qualifications*

**Teachers and health workers are not skilled enough or trained to deliver good service.** This is especially true for personnel in less well-off areas. Teachers and health workers need more training. Almost 30 percent of teachers in rural areas instruct more than one grade at the same time, compared to only five percent in urban areas. Yet, many teachers in rural schools are either untrained or trained only in monograde pedagogy. In addition, they have few teaching or learning resources. Many health centers do not have staff who are capable of performing laboratory tests. Throughout the country, health workers generally receive training from the PHO and DHO two to three times a year, but that number drops to once a year in priority districts.

## **Way Forward**

**In order to build on the progress in education and health outcomes, it is important that Lao PDR allocates more resources to these two priority sectors and improve targeting of the neediest people.** To improve service delivery at the facility level, it is important to remove/minimize teachers' and health workers' salary delays, improve access to equipments, and ameliorate public finance management practice at the subnational levels. Given scarce budget resources, it is important to strengthen accountability among service users, service providers, and government.

**In 2006, the GOL adopted a detailed five-year Public Expenditure Management Strengthening Program (PEMSP).** In addition to enhancing the overall budget process, this initiative also supports adequate fiscal arrangements for the Nam Theun 2 project. This hydro power project is expected to generate revenues from 2009 onwards; the revenue is supposed to be directed to basic social services. The findings of this report, as

well as of the recently completed Lao PDR Public Expenditure Review (World Bank 2006b), suggest that the PEMSP reform agenda lies at the heart of improving basic education and health services.

**At the core of the financial management system are institutional mechanisms for fiscal transfers and monitoring.** The fiscal framework is highly decentralized. As a result, priorities in allocation of funds at the subnational level are often different from those at the central level. Effective implementation of the new Budget Law to improve intergovernmental fiscal relations and develop a new revenue sharing framework is critical for improving the revenue sharing system and treasury. To minimize a mismatch between capital expenditures and recurrent needs, it is important to improve local capacity and to enhance the effectiveness of donor assistance.

**The findings of the PETS have shown that this survey tool can serve as a useful monitoring device for improving public service delivery.** This PETS collects national representative information on facility characteristics and human resources at the district and facility levels. Given its pilot nature, this PETS focuses on tracking teachers' and health workers' salary payments from districts to facilities. With the strengthening of local capacity and improvement of survey design and execution, it would be useful that future PETS aims at obtaining broader quantitative information on leakages of general public resources and identifying binding constraints of education and health service delivery in the overall public expenditure systems. The GOL should implement future PETS to expand on the lessons learned from this pilot experience and to track progress in public financial management and frontline service delivery in education and health sectors.

## INTRODUCTION

*The Government of Lao PDR (GOL) has a policy objective of making major improvements over the next few years in health and education outcomes through improved delivery of public service. The primary objectives of the PETS report are (i) to advise GOL how to improve basic service delivery in the health and education sectors; and (ii) serve as independent monitoring tool to assist government in improving accountability. The analysis is based on a PETS survey which monitors the movement of budget resources from the center to facilities. However, in the Lao case, the fiscal system is highly decentralized. As a result, monitoring is at the subnational level because primary services are the exclusive responsibility of sub-national authorities. Tracking focuses on salary payments from districts to schools/health centers. The PETS report presents findings at three levels (province, district, and facility). These three levels reflect the enormous variety in the nation's economy, geography and ethnicity.*

*The purpose of this chapter is to present an overview of the report. It consists of six sections: (1) the purpose of the report; (2) achievements and challenges in the education and health sectors; (3) the decentralized fiscal system; (4) the chain of accountability in service delivery—long route and short-route relationships; (5) the design, methodology, and limitations of the Public Expenditure Tracking Survey; and (6) conclusions.*

### **The Purpose of the Report**

**The Lao Government's 6th National Socio-Economic Development Plan (NSED) for 2006 to 2010 lays out its overall development framework, its poverty reduction objectives, and a road map to reach these objectives in the medium term. Service delivery is at the center of the development agenda. Part of GOL's development vision is to graduate permanently from its least developed country status and to achieve that by 2020. By 2015, Lao PDR aims to achieve universal primary school enrollment, which would represent a significant increase from approximately 83 percent in 2005. In that same year, Lao PDR wants to lower the mortality rate for children under five years of age to 55 deaths per 1,000 live births, an improvement over 98 deaths per 1,000 live births in 2005.**

**Meeting this ambitious agenda will only be possible if Lao PDR's economy continues to grow rapidly. However, family income generated by growth will only have a modest impact on school enrollment and utilization of health services. Basic**

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health and education are public responsibilities (Box 1). For this vision to be achieved, it will be essential to bring about a greater transfer of resources to these sectors by government, donors, and communities alike. It is difficult to calculate precisely the required funding levels. Nevertheless, it is fair to say that policy and institutional reforms will have to accompany any increase in funding to ensure the money is well spent.

*Box 1: Education and Health—a Public Responsibility*

By financing, providing, or regulating the education and health services, the GOL demonstrates its responsibility for the health and education of their people. Why? First, these services are replete with market failures—with externalities, as when an infected child spreads a disease to playmates or a farmer benefits from a neighbor's ability to read. So the private sector, left to its devices, will not reach the level of health and education that society desires. Second, basic health and basic education are considered fundamental Constitutional rights: "The state implements compulsory primary education" and "...attends to providing health care to all people" (Articles 22 and 25 of the 1991 Constitution). No matter how daunting the problems of delivery may be, the government cannot walk away from this fundamental responsibility. The challenge is to see how the public sector—in collaboration with the private sector, communities, and outside partners—can ensure basic education and health services for all their citizens.

Source: Adopted from World Bank (2003).

**The objective of the present PETS report is to inform policymakers and citizens about whether the budget process and frontline service providers succeed in delivering primary services in education and health to the population, particularly poor people.** It has two main objectives: (1) to analyze management practices relevant to current public expenditures and subsequently advise Lao PDR how to improve the delivery of basic education and health services; and (2) to serve as an independent monitoring tool for the purpose of assisting government in improving accountability.

**Two recent World Bank reports lay out the context for PETS to examine the relationship between public expenditures and education and health outcomes in Lao PDR.** The Lao PDR Public Expenditure Review focuses on public-based revenues and expenditures at the central and provincial levels as expressions of public policy and public participation in the economy. The Lao PDR Poverty Assessment reviews poverty indicators at the micro level over time and by region. It also assesses the impact of growth and public actions on the extent and causes of poverty and inequality. Yet, information on actual budgetary spending of the center, provinces, and districts in Lao PDR is scarce. Budget allocations are a poor proxy for how services reach intended beneficiaries. Consequently, little is known about the budget process that exists between the frontline facilities and the center as well as the impact of public spending on education and health outcomes. PETS aims to close such gaps by tracking the flow of resources at the subnational level and by providing information on frontline service delivery. It links downstream with an analysis from Poverty Assessment on education and health outcomes at the household level, and upstream with an analysis from Public Expenditure Review on public expenditures of the layers of the nation, provinces and districts.

**Typically, PETS tracks how public resources flow from the center to the frontline, then identifies how much of the original allocations reach each level and how effectively the services are delivered.** In Lao PDR, the fiscal structure is highly decentralized. Provinces and districts are responsible for delivering primary social services to households. Due to the weakness in financial controls, accounting, and reporting systems, records are not always available or reliable on the amount and timing of the flow of funds from each province to each district within that same province and from each district to the facilities within it. The main source of capital investment in Lao PDR comes from donor support. To track government expenditure, PETS focuses on recurrent spending. In the education and health sectors, human resources are the principle vehicle for the delivery of social services; as a result, salaries account for the bulk of recurrent expenditures. For tracking purposes, PETS focuses on the linkage between districts and facilities, particularly the flow of salary payments to teachers/health workers from districts to schools/health centers.

**This PETS complements the 2002/3 household survey Lao Expenditure and Consumption Survey III (LECS), which offered a comprehensive and nationally representative picture of social service delivery.** It documents staffing and equipment at frontline services, including what goes on in schools and health centers; what teachers and nurses/doctors do; and how textbooks and drugs reach people. This report has three distinct features:

- It is based on the 2002/3 LECS sample which provides nationally representative findings; the sample is based on 17 provinces, 54 districts, and 252 villages;
- This link implied the need to focus on lower levels of service delivery, namely districts and facilities; and
- Government priorities suggested focusing on human resource issues, including salary levels and payment delays.

## **Education and Health Sector Context**

**Lao PDR has made strides since the launch of economic reforms.** As one of the poorest countries in East Asia, Lao PDR has a sense of urgency about its development. The NSEDP lays out the specific targets and indicators for poverty and social sectors for 2010, it also endorses the 2015 Millennium Development Goals (MDG) for Lao PDR as set forth in the 2004 MDG-Report. They reflect an unprecedented global commitment for reducing poverty, presented as time-bound, outcome-based targets to focus strategies. Low income, illiteracy, poor health, gender inequality, and environmental degradation are all aspects of poverty. Five of the eight goals concern health and education.

**Lao PDR has made progress towards achieving education and health MDGs; nevertheless, challenges remain.**

Progress has been positive in the following areas:

- gender equality: the ratio of girls to boys in primary and secondary school has increased; so has the number of literate women to men from the 15 to 24 age group;
- death rates from malaria and tuberculosis have decreased; protection in malaria risk has increased, and the proportion of detected and cured tuberculosis cases have gone up; and
- access to water and sanitation has also improved.

Progress is mixed on the following:

- there has been a reduction in the infant mortality rates and for children under-five; however, the proportion of children immunized against measles has declined; and
- on a positive note, there has been a drop in maternal mortality rates and an increase in the use of contraceptives, but the share of births assisted by skilled personnel has increased only very slowly.

Progress is lacking:

- achieving universal primary education is a distant goal because increases in net primary school enrollment rates have been slow according to LECS; the same is true of completion rates for primary school and literacy rates for young adults aged 15 to 24 years.

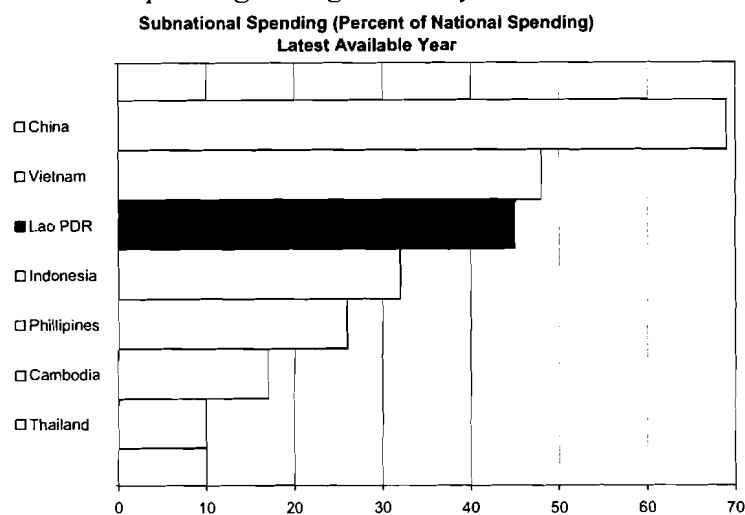
**However, the assessments should be qualified in four ways.** First, there are discrepancies between administrative and survey data for some indicators, especially school enrollment. Second, the data refer to national trends only and do not shed light on rising or falling disparities across subgroups. Third, some information is up to five years out-of-date and does not reflect recent changes. Finally, meeting the targets will be a stiff challenge. For example, the targets for poverty, gender equality, malaria, tuberculosis and water will be met only if current trends persist. Maintaining progress is different from launching it. As easy gains are exploited, further advances are increasingly more difficult.

## **The highly decentralized fiscal system**

**Lao PDR is one of the most decentralized countries in East Asia.** Subnational administrations raise around three-fifths of total revenues and spend almost one-half of total expenditures (Figure 1). Provinces have *de facto* autonomy in collecting revenue, in allocating it within envelopes set by the center, and in establishing their budget process (Box 2). Provinces and districts are responsible for the delivery of most services in

education, health, transport infrastructure and rural development. These are the sectors GOL identified as priorities for meeting NSEDG's goals.

*Figure 1: Lao PDR's subnational authorities account for almost one-half of total government spending, a large share by East Asian standards*



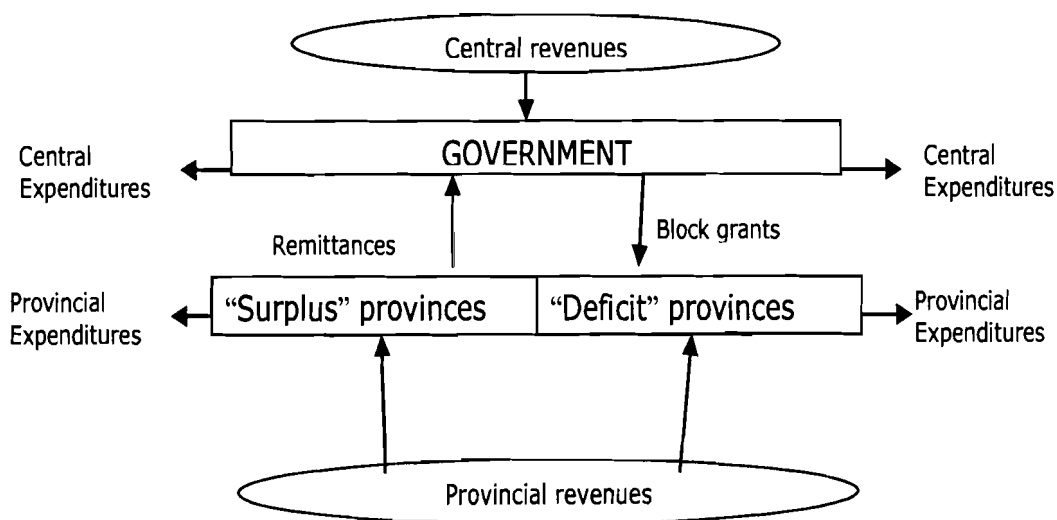
Data source: World Bank (2006b).

**Provincial governors play a very important role in public financial management.** Budget resource flows are horizontal instead of vertical. District and provincial offices collect and retain all revenues within the areas assigned to them (income taxes and some tax on natural resource from all payers, taxes on profits, excise and turnover taxes from medium-sized payers). Then these offices use the revenues to fund their budget expenditures. Provinces that collect tax revenues have the ability to negotiate how much tax revenue they will remit to the central government and how much they will retain. In Lao PDR, the budget allocations depend mainly on negotiations between provincial governors and the central government instead of explicit rules. At the provincial or district levels, the allocation of resources to different sectors, including education and health, is up to the provincial governors rather than the central ministries (World Bank, 2006d). Therefore, the amounts spent on each sector (or as a share of total budget expenditures) vary drastically across provinces. As to the sub-national administration, the provinces essentially mimic the center (Box 3). Provincial finance offices comprise the following: treasury, customs, tax, and budget departments. These departments are controlled by the office of the provincial governor. A similar structure exists at the central level and is under the Ministry of Finance. Administrations with deficits (districts or provinces) can receive a transfer of funds from administrations with surpluses. These transfers, which go from the higher level to a lower one, are block grants. Such transfers come through the Provincial Financial Offices (PFO) and District Financial Offices (DFO) of the Ministry of Finance; they are not earmarked by sector or service.

## *Box 2: Central-Local Relationships*

The 1991 Constitution laid the foundation for a national budget based on the concept of a unified, decentralized state. Article 75 of the Constitution specifies that there are three layers of subnational administration. Provinces and districts formulate budgets. The budget, authorized by the National Assembly, defines revenue targets and allocates expenditures for the center and for the provinces. In 2000, Prime Ministerial Decree 01 (PM 01) extended this framework by granting provinces wide responsibility for fiscal management. This decree established “provinces as the strategic unit, districts as the planning unit, and villages as the implementing unit.” The decree granted the provinces *de facto* autonomy in collecting revenue, in allocating it within envelopes set by the center, and in establishing their budget process. The decentralized fiscal structure is based on an “upward revenue sharing” system in which the provinces collect most revenues. Rich provinces are to transfer surplus revenues to the center to fund both central government expenditures and transfers for the “deficit” provinces. However, rich provinces have little incentive to give to poor provinces. An equivalent transfer system from surplus to deficit districts, with similar incentive problems is in place within provinces.

Lao PDR’s central-provincial fiscal system is portrayed in simple terms in the diagram below. Provinces collect about 60 percent of total revenues, 90 percent of which they retain. These funds account for about one-half of total provincial expenditures. Provinces with a surplus after expenditures remit the difference to the center; they also collect their own assigned revenues. Provinces that have budget deficits receive unconditional block grants from the central government. There is no provincial borrowing. Provinces can and do incur liabilities on behalf of the center by running up arrears on commitments to private contractors or civil service salaries. But they cannot borrow from financial institutions in their own right.



Subnational authorities have extensive fiscal and functional responsibilities; they also control the exercise of these responsibilities. For example, they are in charge of delivering infrastructure and services related to:

- primary and secondary education
- primary and secondary health
- water supply and reticulation
- agriculture support and extension;
- non-national roads and other transport infrastructure; and
- environmental management.

Source: World Bank (2006c).

### *Box 3: Subnational Administration*

When it comes to administration, the provinces essentially mimic the center. The Governor's Office is equivalent to the Prime Minister Office. Every line ministry has a provincial line agency that reports to the line minister and the Governor's Office. Similar to the central government, the Provincial Planning Office and to a lesser extent, the Provincial Finance Office, play a key role in making decisions about expenditures. But they are always under the supervision and approval of the Governor's Office. Provincial governors have important but not exclusive controls over senior appointments in provincial and district level offices of line ministries. However, the role of the districts in the provincial structure is less significant than that of the provinces in the national context. District governors do not have significant autonomy in sectoral allocations or in funding their districts. Policy making is concentrated at the provincial level.

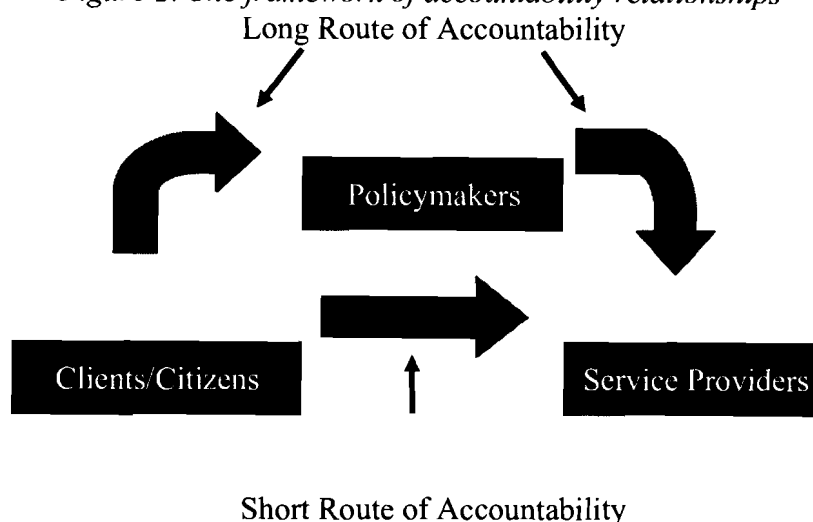
Source: World Bank (2006d).

**The provision of primary services in Lao PDR is the exclusive responsibility of subnational authorities.** Provincial expenditures for education and health represent more than two-thirds of total spending. This makes the effectiveness of subnational spending a crucial concern of the central government. GOL is having an internal dialogue to develop consensus on these issues - and on the actions that may be taken to address them.

## **Accountability—Long- and Short-Route Relationships**

This PETS report refers to a framework of long-route and short-route accountability as set forth in the 2004 World Development Report—**Making Services Work for Poor People**. The framework is a flexible device for discussing a range of issues that impact the delivery of basic services for education and health in Lao PDR. The service delivery chain can be unbundled into the accountability relationships between three sets of actors—the policymakers; the frontline providers of services; and the citizens or clients who utilize the services—and two routes of accountability – “short route” from clients to service providers and “long route” from citizens to policymakers to service providers (Figure 2). “Short route” of accountability—in a competitive market transaction, students/parents and patients as clients hold service providers schools/health centers accountable through the power of the purse; they pay for satisfactory service or take their business elsewhere. “Long route” of accountability applies to many basic services, such as education, health, water, electricity, sanitation. In this situation, service providers are not directly accountable to clients. The societies have decided, frequently for good reason, that the government will provide, finance or regulate these services. Under the long-route, clients as citizens must influence policymakers; policymakers in turn must influence providers to bring about effective service delivery.

*Figure 2: The framework of accountability relationships*



The triangle in figure 2 highlights what is required for effective public action: a state that is strong in setting objectives, enforcing regulations, and providing adequate resources; providers that have a clear vision and mission of service, who act with professional autonomy and initiative; and empowered citizens who demand services. These three actors should be embedded in strong relationships of accountability, but establishing such relationships in primary education and primary health care is difficult. Private and collective objectives have to be aligned.

**When relationships along either “long-route” or “short-route” of accountability break down, service delivery suffers.** In the education and health chapters, on the long-route, this report focuses on: (i) public funding to discuss the relationship between citizens and policymakers; and (ii) expenditure management to discuss the relationship between policymakers and service providers. On the short-route, this report focuses on frontline services to discuss the relationship between clients and service providers.

**However, it is not easy to impose and enforce outcomes on service providers because of the multiple and complex objectives of education and health.** First, primary education and health services are discretionary and transaction-intensive. It is difficult to know whether they worked well. Second, the day-to-day pressure of local demand for health care can sometimes compromise efforts in disease prevention and other public health activities that are not demand-driven, in particular when resources are tight. Third, education and health outcomes cannot be solely attributed to the actions of service providers; there are important “co-producers”. For example, health and education outcomes are closely associated with household and community behavior.

## Public Expenditure Tracking Survey–Design, Methodology and Limits

The Lao PDR Public Expenditure Tracking Survey Project began in June 2004 as a partnership between the Government of Lao PDR and the World Bank. Ten government officials initiated it at an international training workshop in Cambodia (Table 1). Based on the rapid assessment for determining the availability of records at various layers of government, the scope of PETS was defined and approved by its steering committee. After designing and field-testing the questionnaires in October 2005, the PETS steering committee gave a go-ahead for the field survey in December 2005. The trainees consisted of 40 enumerators including nine supervisors. Based on a request by the PETS steering committee, the enumerators were experienced employees of the provincial health and education offices and provincial statistical departments. The field work took place from January 31 to March 11, 2006. After data entry and cleaning, NSC submitted the dataset to the World Bank for analysis in September 2006. It is worth noting that the Ministry of Finance, Ministry of Education, Ministry of Health, Department of Public Administration at the Prime Minister's Office, the National Statistics Centre, and the World Bank participated throughout the project cycle. The NSC, which is widely recognized for its unique capacity for data collection and analysis, was in charge of the survey work. Its official status as a statistical agency is a requirement for collecting sensitive information on public resources and staffing across layers of government. A steering committee, working group, and a secretariat coordinated and guided the work.

*Table 1: PETS Timeline*

1	International PETS Workshop, Phnom Penh	Jun-04
2	Rapid Assessments	Sep 04 to Dec 04
3	Questionnaire Design and Field Testing	Jun 05 to Oct 05
4	Enumerator Training	Jan-06
5	Field Survey	Jan 06 to Mar 06
6	Data cleaning	Apr 06 to Sep 06
7	Analysis and Report Writing	Oct 06 to Mar 07

Given the pilot nature of the project and the complexity associated with its implementation, PETS wanted to keep the evaluation simple and focused on high level priorities. Of the three GOL fiscal reform areas—allocation of public spending; government budget planning and processing; and revenue mobilization—PETS offers information on the first two. Specifically, PETS explores the impact of public expenditure management and human resources on education and health service delivery by:

- documenting financial and human resources at subnational levels;
- tracking salary payments from districts to facilities;



- correlating performance with actual service delivery; and
- proposing policy reforms on expenditure management practices.

**The survey approach emulates the methodology of the World Bank's public expenditure tracking survey ([www.publicspending.org](http://www.publicspending.org)).** Within East Asia, such surveys have occurred in Cambodia, East Timor, Papua New Guinea and Thailand. However, the issues of public service delivery in Lao PDR are different from other countries. The content of the PETS came about based on the findings and recommendations of the rapid assessment reports for education and health, and after consultation with the government and other stakeholders.

**The PETS questionnaire consists of three parts (Table 2).** First, it includes a series of quantitative assessments of budget flows at the various levels (province, district, and facility levels). The first goal was to explicitly record the funds that are allocated to primary schools and health centers and to track the funds for salary payments from the district to facility levels. Second, a facility level survey collected detailed information on inputs, including public funds, outputs and outcomes for primary schools and health centers. Information was collected in questionnaires and data sheets. Third, data on community characteristics was recorded through a scaled-down version of the village questionnaire of the 2002/3 Lao Expenditure and Consumption Survey.

**The focus of the survey is to collect information at the facility level to relate it upstream to the province and district levels, and downstream to the household levels.** That is because primary education and health are the responsibility of provinces and districts; and because the users of schools and health centers are households. The PETS sample was based on schools and health centers in villages surveyed by the 2002/3 Lao Expenditure and Consumption Survey ("LECS villages"). One operational advantage of this sampling was that the NSC was familiar with the location and village representatives. An analytical advantage of this sampling design was that this PETS was derived from a nationally representative household survey that covered 17 out of 18 provinces and 56 out of the 141 districts (Figure 3). In contrast, most PETS take place in selected areas of a country to conserve spending on the cost of field work. As of 2003, there were 8,451 primary schools and 717 health centers in Lao PDR. Based on this number and the experience of other PETS surveys, the target number of primary schools was 259, the number of health centers was 114. The target was off by seven for both the schools and the health centers. The results presented in this report are weighted to replicate the same population as the LECS 2002/03; weighted and unweighted statistics generally do not differ substantially though. Similarly, nominal variables, such as budgetary spending, are deflated with the spatial price index embedded in the 2002/03 poverty line. These steps ensure that comparisons across localities adequately reflect cost differences. The PETS did not interview users of facilities separately. Village level household information from the LECS 2002/03 was merged with the PETS data to evaluate how characteristics of facilities and the management of public expenditures correlate with health and education outcomes.

*Table 2: Modules of the PETS Questionnaire*

- |   |                            |
|---|----------------------------|
| 1 | Province Financial Office  |
| 2 | District Financial Office  |
| 3 | Province Education Service |
| 4 | District Education Bureau  |
| 5 | Primary School             |
| 6 | Province Health Office     |
| 7 | District Health Bureau     |
| 8 | Health Center              |
| 9 | LECS Village Survey        |

*Figure 3: District-Level Map of the PETS Survey  
(Survey Districts are Marked in Dark Green)*



**The PETS report presents findings at three levels (province, district, and facility).** The aim was to capture the enormous variety in economy, geography, and ethnicity of Lao PDR that reflects the context and conditions under which service delivery operates (Table 3). At the provincial level, findings are presented separately for surplus provinces as distinct from deficit provinces. Deficit provinces have a weaker economic base and less financial autonomy than surplus provinces. According to their financial status in the 2003/04 Official Gazette, five provinces, Borikhamxay, Champasak, Luangnamtha, Savanakheth, and Vientiane Capital are considered surplus provinces; the remaining 12 are

considered deficit provinces. There are separate findings for “priority” districts and “non-priority” districts, as defined by the government.<sup>1</sup> Of the 56 districts in the survey, 10 are priority districts and 46 non-priority districts. Within districts, living standards differ from village to village. There are separate findings presented for urban areas and rural areas, non-poor areas and poor areas<sup>2</sup>, Lao-Tai areas and non Lao-Tai areas<sup>3</sup>. Out of the 252 schools covered by the survey, 66 are in urban areas, 186 in rural areas; 168 in non-poor areas, 84 in poor areas; and 191 in Lao-Tai areas, 61 in non Lao-Tai areas. Of the 107 health centers covered by the survey, 33 are in urban areas, 74 in rural areas; 71 in non-poor areas, 36 in poor areas, and 91 in Lao-Tai areas, and 16 in non Lao-Tai areas. Due to geographic remoteness and the lack of development of human resources, the rural areas, poor areas, and non Lao-Tai areas are generally less developed than urban areas, non-poor areas, and Lao-Tai areas. Because the services in the former are not as satisfactory as the latter, the report refers to the former as “less well-off areas” and the latter as “well-off” areas.

*Table 3: Analytic Domains*

LAYER	DOMAIN	OBSERVATIONS (#)	
Province	Surplus	5	
	Deficit	12	
District	Non-Priority	46	
	Priority	10	
Facility	Urban	Schools	Health Centers
		66	33
	Rural	186	74
	Non-Poor	168	71
		84	36
	Lao-Tai	191	91
		61	16

<sup>1</sup> Within provinces, there is a total of 143 districts. Of these, 47 are considered priority districts in need of public investments to attain their poverty reduction targets. These 47 districts were identified based on a set of household, village, and district level indicators for basic minimum needs.

<sup>2</sup> The poverty rate of a village reflects the average level of poverty across 15 households in that village, based on interviews for the 2002/03 LECS. If the poverty rate of a village is higher than the median of the national average, the village is considered poor; otherwise, non-poor.

<sup>3</sup> The population of Lao PDR can be grouped into four broad ethno-linguistic categories: Lao-Tai, Mon Khmer, Hmong-lu Mien and Chine-Tibet. If the share of Lao-Tai ethnicity in a village is higher than the median of the national population average, the village is considered Lao-Tai; otherwise, it is non Lao-Tai.

**Ideally, tracking the flow of public expenditures from the central level to the provincial level, from the provincial level to the district level, and from the district level to the facility level would be important.** The same is true about the need to quantify the efficiency/leakage of this process and to identify possible weak links. However, in Lao PDR, reliable data is not always available on the timing and amount of resources that flow from each source to the intended recipients. Reliable data is also lacking on the timing and amount of resources that recipients receive from each source. This PETS has a narrow focus; it tracks salary payments which flowed to schools and health centers from the districts. It does not address or quantify the leakage of general public resources from the center to the provinces, from the provinces to the districts, and from the districts to the facilities for any expenditure other than salary payments. Nor is it intended to pinpoint where and to what extent leakage exists in the overall system. Reliable information on resource inflows from sources other than the government budget is not always available. Therefore, results must be interpreted with caution.

**This PETS tracked and compared salary payments made to individual teachers/health workers, based on records at the district and facility levels.** The findings show that leakages of teachers' and health workers' salaries from districts to facilities is not a big problem. Differences in salaries reported at the facility level and district level are just a few percentage points. Further information, such as the amount of money that comes to the schools or health centers from sources other than the government budget and how it is actually spent, would be helpful to support this conclusion and to better understand financial management at the facility level. Survey results indicate that schools and health centers rely heavily on off-budget resources from donors, NGOs, parents/patients and community contributions to finance their operating costs.

**The quality of survey data is sometimes unsatisfactory.** Some respondents at the facility, district, and provincial levels are unfamiliar with accounting. For example, some individual responses to questions about financial surpluses and deficits of PES/PHO and DEB/DHO were inconsistent with their responses to another section of the questionnaire. These responses reflect a lack of understanding of basic accounting principles, such as revenues and expenditures. These concepts are fundamental to the profession and pivotal to a public expenditure tracking study. The fact that some respondents failed to grasp these principles undermines the scope and depth of this PETS report.

**Given the weaknesses in financial control, accounting, and reporting systems in Lao PDR and the pilot nature of this first PETS, it is unrealistic to expect perfect information.** Currently, documentation is almost entirely paper-based. Formats and nomenclatures are often inconsistent. Records are kept in various books and rarely reconciled. Basic accounting concepts are not always understood. These realities hampered PETS in the collection of accurate information.

## Conclusions

**This PETS aims to provide information on primary education and frontline health services.** It also sets out to track salary payments to teachers and health workers from districts to facilities. The survey is designed to link downstream with an analysis from Lao PDR Poverty Assessment; and upstream with an analysis from Lao PDR Public Expenditure Review to track the flow of resources from sub national levels and to provide information on frontline education and health service delivery from a national perspective.

**The report sets out to document how resources flow through layers of subnational authorities to reach schools and health centers.** It examines what factors affect frontline services by referring to a three-way accountability relationship between clients/citizens, policymakers, and service providers. It presents a snapshot of financial flows and human resources at the provincial, district, and facility levels separately for surplus provinces and deficit provinces, priority districts and non-priority districts, urban areas and rural areas, poor areas and non-poor areas, and Lao-Tai areas and elsewhere.

## EDUCATION

*Education is a vital part of a person's capacity to lead a life he or she values. More education is linked to better family health, greater participation in society, higher productivity, and thus a reduced risk of poverty.*

*Education outcomes improved in Lao PDR in the past decade, although in the aggregate they are still below the East Asian standard. Teachers are satisfied with their jobs and are highly motivated; their rate of absenteeism is low; ghost-teacher phenomenon is uncommon; parents' and communities participation is active; leakage of teachers' salaries from the district level to the schools is low.*

*However, to achieve the level of education identified by the MDGs and the National Education for All Action Plan, more progress is needed. In the last decade improvements in education have not been evenhanded. Disparities between well-off areas and less well-off areas are large. The level of public funding is low; in 2004/2005 it represented only 1 percent GDP. The inequitable distribution of resources and inefficient management of public expenditures have reduced the effectiveness of education spending, which is limited at best.*

*Two factors constrain service delivery at the facility level—low salaries and frequent delays in the payment of teachers' salaries as well as inadequate operating funds. Both of these are the result of insufficient public expenditures for education. Poor children in less well-off areas are more likely to suffer even more because they have less access to school, particularly schools of decent quality.*

*This chapter: (1) reviews the changes in education outcomes; (2) examines the level and allocation of public education funding; (3) analyzes the weaknesses in the management of public expenditures; (4) presents a snapshot of education service delivery at the frontline and an analysis of its key constraints; and (5) conclusions.*

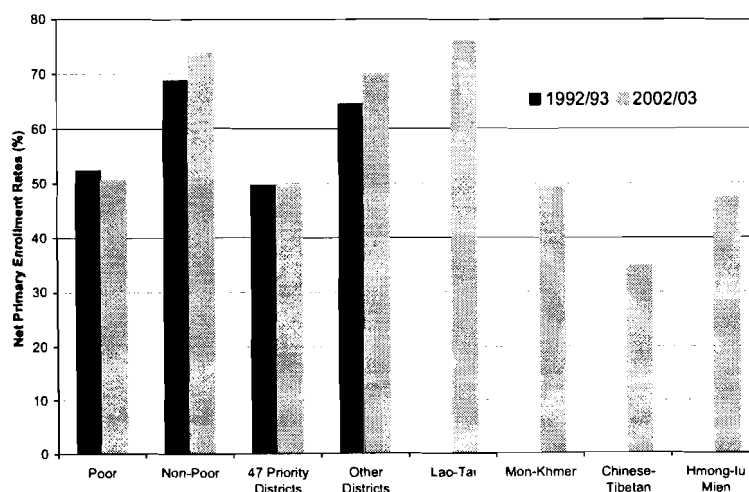
### Outcomes

**The overall education outcomes in Lao PDR improved in the past decade.** Both survey data and administrative data suggest that Lao PDR is making progress towards meeting the education MDGs, although administrative data displays a more favorable picture. According to the LECS, the net primary enrollment rates increased from 61 percent in 1992/3 to 65 percent in 2002/3; in contrast, 2005 Population Census indicates a

net primary enrolment rate of 83 percent in 2005.<sup>4</sup> However, enrollment in first grade does not guarantee completion of the primary cycle. According to the LECS, no more than 70 percent of male students and fewer than 60 percent of female students are still in school at the end of the fifth grade. Just three out of four boys and two out of three girls who completed five years of primary education go on to secondary school.

**However, disparities in school enrollment widened between priority/non-priority districts, poor/non-poor and Lao-Tai/non-Lao-Tai areas.** According to LECS data, the net enrolment gap for primary education between poor and non-poor children widened from 16 percent in 1992/3 to 24 percent in 2002/3 (Figure 4). The disparity from priority to other districts increased by five percent. Similarly, there are stark differences across the four broad ethno-linguistic categories. Net primary enrolment rates were 76 percent among the Lao-Tai, compared to 49 percent among the Mon-Khmer, 35 percent among the Chinese-Tibet, and 47 percent among the Hmong-lu Mien in 2002/03. Administrative data confirm these differences. Gender disparities have narrowed but slowly. The number of girls enrolled per 100 boys rose from 82 in 1992/93 to 86 in 2002/3. In 2005, the female net primary enrollment rate was 6 percentage points below the one for male. According to the Lao Population Census (2005), the 2004/05 net primary enrolment rates were 73 percent in priority districts and 90 percent in other districts; literacy among 11 to 16 year-old was 84 percent for Lao-Tai and 61 percent for non-Lao-Tai. To achieve the objective of the education policy of NSEDP and that of the National Education for All Action Plan, universal primary education by 2015, more progress needs to be made, especially in less well-off areas.

*Figure 4: There are large disparities in education outcomes by poverty, area, and ethnicity.*



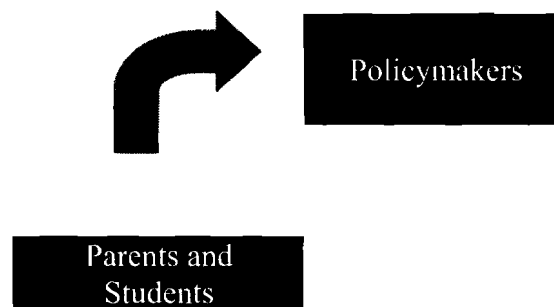
Data source: LECS 2002/03.

<sup>4</sup> The discrepancies in the net primary enrollment rate between the 2005 administrative data and the 2002/03 survey data appear large. However, small discrepancies are not uncommon. One reason is that the administrative data tend to capture beginning-of-year enrollment while the survey data tend to capture school attendance.

## Public Funding

**The low level and inequitable allocation of public education funding are major constraints in Lao PDR.** The less satisfactory education outcomes for poor people and for people in less well-off areas are closely associated with their inferior access to schools and the unsatisfactory quality of schools they can access. The limited public education funding disproportionately accrues to the non-poor as poor people have little clout with policymakers on budget decisions. They may not be well informed about the quality of public service or place less weight on public services (Figure 5).

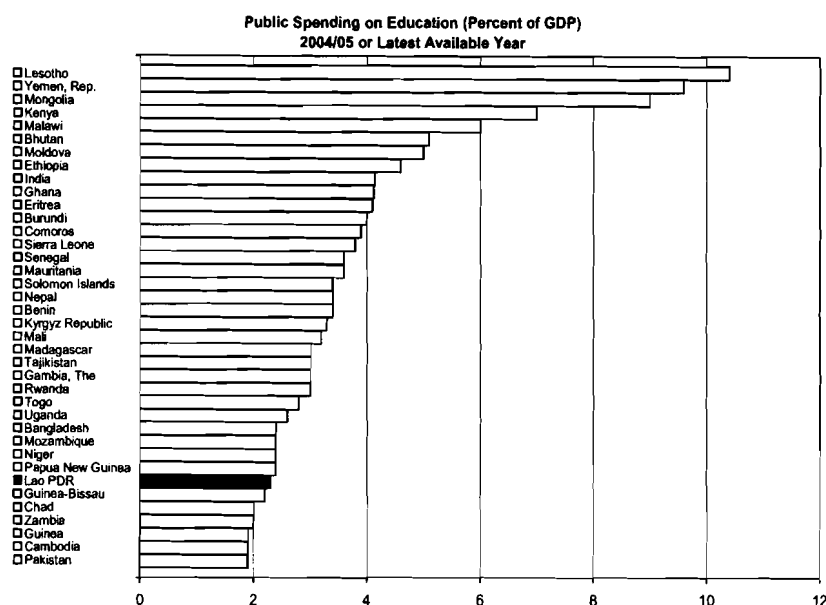
*Figure 5: Poor parents/students have little clout with policymakers on budget decisions*



**Based on international comparisons of low-income countries, Lao PDR stands out for its scant budget allocations for education** (Figure 6). While government spending on education has increased since 1998/99 (Figure 7), it rose mainly because of higher donor assistance. Between 1998/1999 and 2004/05, total public expenditures on education rose from 1.2 percent to 2.3 percent of GDP while domestic outlays fell from 1.1 percent to 1.0 percent of GDP. Funding is still below its peak in the mid-1990s. Public education spending as a share of overall government spending was about 11 percent in 2004/05 compared to about 15 percent in the mid-1990s; as a percent of GDP was about 2.3 percent in 2004/05 compared to around 3 percent in the mid-1990s. Consequently, the education system at the primary level operates with very frugal resources. The unit spending of a pupil in primary school is only 2 percent of per capita GDP in Lao PDR compared to around 7 to 14 percent in most developing countries (World Bank 2006b).



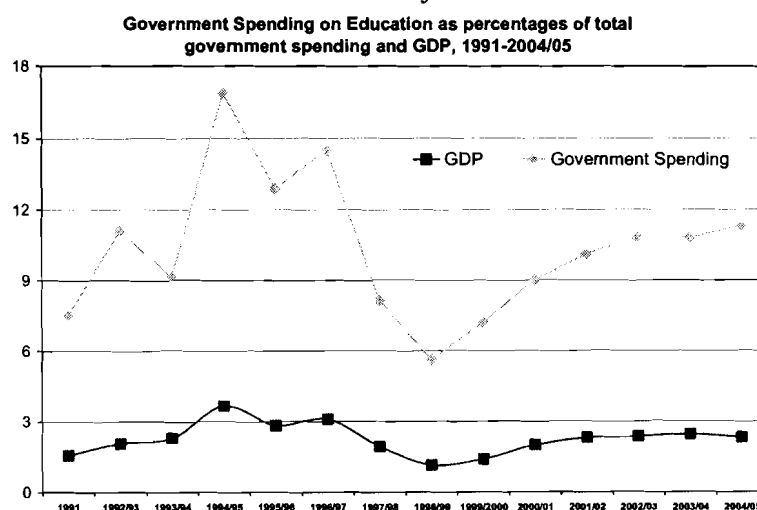
Figure 6: Lao PDR stands out in international comparison for its low spending on education.



Data source: WDI 2005 and the World Bank (2006b).

At each sub-national level, insufficiency of public funding is the single most pressing problem for education departments, especially in less well-off areas. In 2004/05, the approved budgets of all PES were lower than their proposed amounts. For 10 out of the 16 PES surveyed the reason provided was insufficient funds at the PFO. The bulk of the education budget adjustment fell on deficit provinces and priority districts. Overall, close to two-thirds of the DEBs received lower allocation of funds than proposed; the number raised to four out of five DEBs in priority districts. For two-thirds of DEBs, the reason of budget cut is the lack of funds at the DFO.

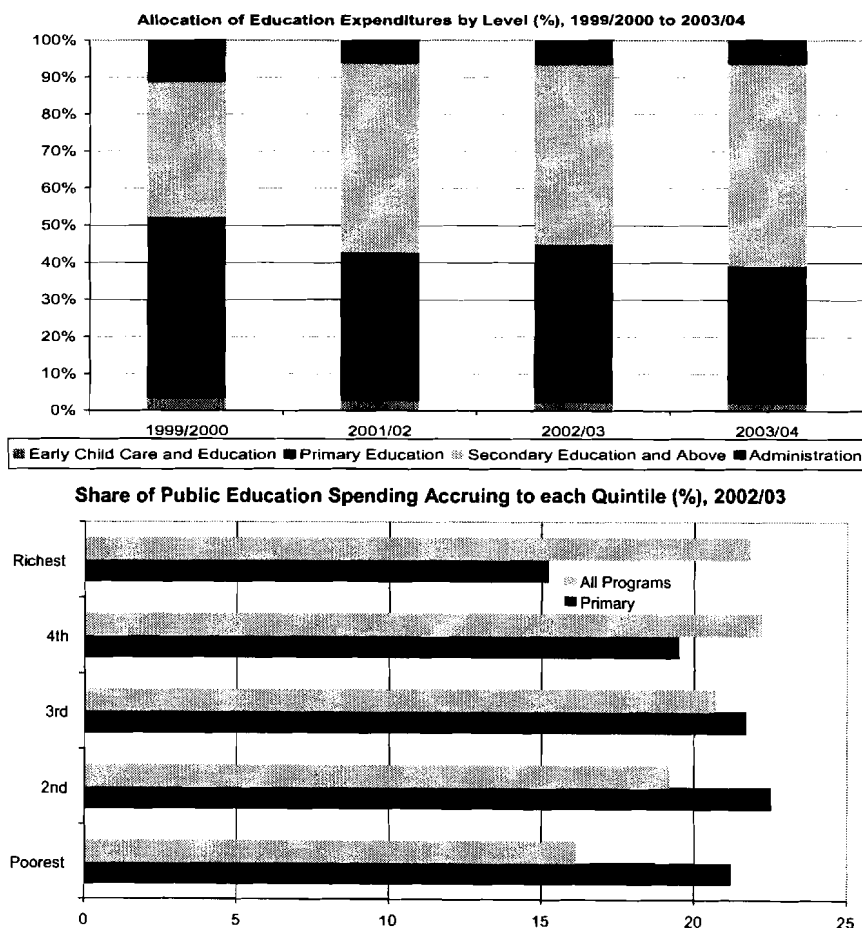
Figure 7: While public educational expenditures have increased since the late 1990s, it still remains below levels from the mid 1990s.



Data source: The World Bank (2006b).

A shift of public education funding from primary to secondary schools and above diverts the already limited resources away from the people who need it most. A sharp rise in secondary, technical, vocational and higher education enrollments has put a dent in the share of primary education spending (Figure 8). Primary education spending fell from 49 percent in 1998/99 to less than 40 percent in 2004/05 out of overall recurrent expenditures on education (World Bank 2006b). Since poor people have a lower stake in secondary and tertiary education than in primary education, this change has made the incidence of public education spending more inequitable and less consistent with the declared policy focus on achieving universal primary education. Only one-sixth of public education spending on all programs accrued to the poorest quintile of population in 2002/03; compared to about 22 percent of public spending on primary education accrued to the poorest quintile.

Figure 8: As education spending has shifted away from primary education, it puts poor people at a further disadvantage.

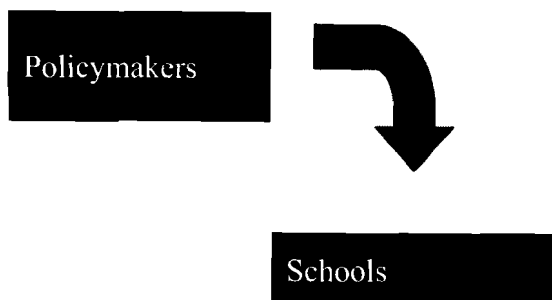


Data source: The World Bank (2006b).

## Expenditures Management

**Lao PDR's management of public expenditures for education is weak.** For policymakers to ensure schools to deliver efficient service there is still a long way to go to improve budget preparation, execution and reporting, and to strengthen local capacity (Figure 9).

*Figure 9: Policymakers may not be able to ensure schools deliver efficient services.*



## Budget Preparation

**Five weaknesses—lack of realism, a significant amount of off-budget funds, fragmentation, a weak bottom-up process, and a compressed budget cycle—characterize the budget preparation process.** On the plus side, the process is largely in line with regulations (Box 4).

### *1. Lack of Realism*

**The provincial budgets approved by the National Assembly as part of Lao PDR's unified budget are often lower than the proposed budget.** The latter is based on revenue forecasts that are unrealistically high. Sound fiscal practice demands that expenditure plans should be based on realistic forecasts of fiscal revenue. The lack of budget planning realism leads to ineffective budget execution. High revenue projections serve the center's agenda in terms of mobilizing high revenues from the provinces, while surplus provinces have little repercussions to fear when they do not meet those targets. When a large share of these revenues fails to materialize, budget becomes a weak planning tool. GOL has to reduce budgeted spending amounts by cash rationing.

**As budgeting tends to be incremental, unrealistic expenditure envelopes perpetuate themselves.** For the 2005/06 budget, 15 out of 17 PFO that provided budget ceilings to PES based them on last year's (planned) expenditures. This process can seriously distort the priorities embedded in the budget, as education and health expenditures can often be squeezed below budgeted amounts when revenues fail to materialize. It also weakens the policymakers' authority as treasury officers—rather than the National Assembly—end up deciding which invoices to pay and which to add to accounts payable.

#### *Box 4: Budget Process in the Education Sector*

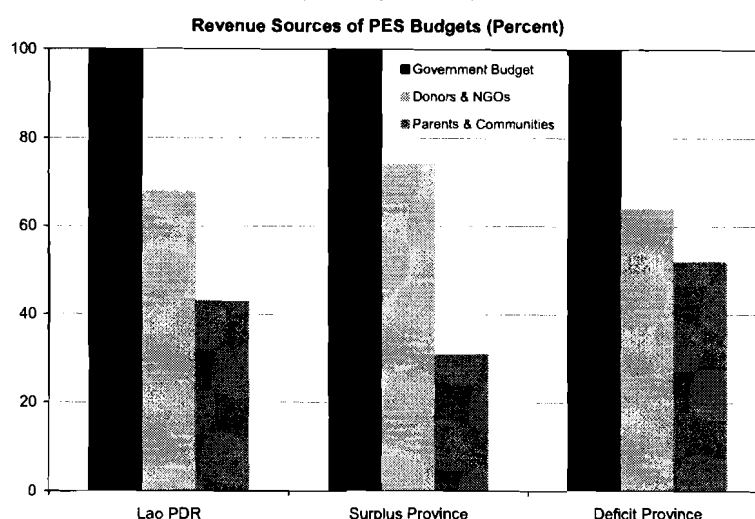
1. The Office of the Prime Minister (PM), the Committee of Planning and Investment (CPI) and the Ministry of Finance prepare general framework of procedures and guidelines, which are sent to MOE and the other ministries.
2. MOE produces guidelines outlining national priority and targets for the education and training sector, which are sent to all Provincial Education Services and higher education institutions (HEIs – NUOL, TTC, and others) in April, and the PESs send the Ministry of Education guidelines to District Education Bureaus.
3. The DEB prepare their draft budgets, which are returned to the PES.
4. The PES summarize and consolidate the DEB draft budgets and their own budgets, which are submitted to the Provincial Planning Service (PPS) and Provincial Finance Office (PFO). The draft budgets prepared by PES and HEIs in May contain both the investment and recurrent needs of the each province and the various institutions. The PPS and PFO submit the draft consolidated budgets to the Department of Planning and Cooperation (DOPC) and Department of Finance (DOF) in the central MOE office.
5. DOPC and DOF review the draft budget plans submitted and consolidate them into a single MOE draft budget.
6. The MOE draft budget is represented at a meeting, chaired by the Minister of Education in June. At this meeting, MOE priorities are fixed based on the CPI and MOF guidelines and the provincial budget requests. The outcome of this meeting is the consolidated first draft of MOE's budget, which is submitted to CPI and MOF in July.
7. When all ministries have submitted their draft budgets, CPI and MOF chair several seminars to discuss the financial report, anticipated revenue, and the anticipated loan-grants activities for the forthcoming year. Based on the outcomes of the discussions and the submitted draft budgets from the various ministries, CPI and MOF prepare a final budget plan to be submitted in a July government's meeting.
8. The National Assembly then reviews and approves the plan in late September.
9. When the plan is approved, the Prime Minister decrees the execution of the budget plans and CPI and MOF distribute them to the various ministries and provinces.
10. Since 2000, MOE upon receiving the approved allocated budget from MOF, distributes it as the "school attachment"; MOE is responsible for Technical Schools, Teacher Training Colleges and the Ethnic Minority Schools, a total of 30 schools and institutions.
11. At the province level, PFO distributes allocated Education Sector budget to PES and DFO.

Source: Noonan (2001).

## *2. Off-Budgetary Funds*

**Heavy reliance on off-budget funds compromises the effectiveness of the budget process.** About two-thirds of PES receive funding from donors and about two-fifths from communities. Surplus provinces are more likely to obtain donor funding and deficit provinces are more likely to rely on community contributions (Figure 10). The absence of off-budgetary resources in the budget means that the budget does not capture the whole picture of actual allocation of resources between national priorities or across provinces. It is unclear whether and how these receipts are captured in their budgetary financial reporting.

*Figure 10: While all PES receive government funds, surplus provinces are more likely to obtain donor funding and deficit provinces are more likely to rely on community contributions.*



Data source: PETS.

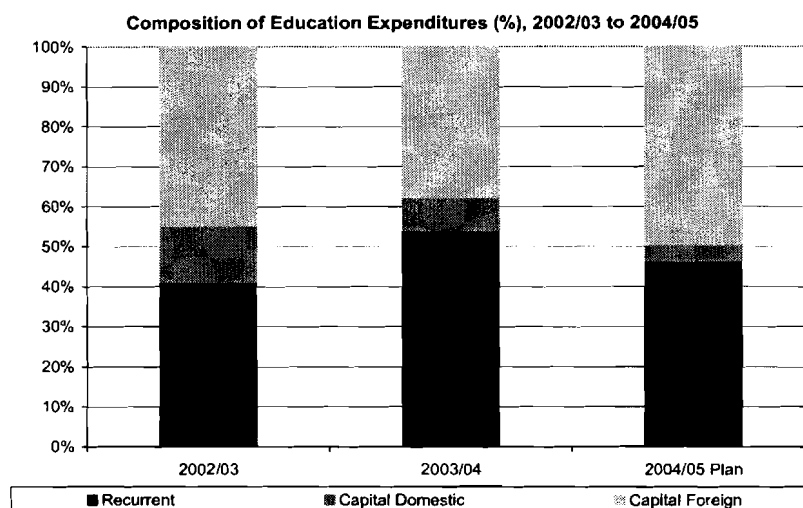
### 3. Fragmentation

**Finance and planning functions at the central and local levels are fragmented and coordination between capital and recurrent expenditures is weak.** Due to low domestic resources, a large part of education funding comes from abroad. The share of foreign financing increased from 30 percent in 2001/02 to close to 40 percent in 2003/04, allowing for a rise in government spending on education. In 2003/04, around four-fifth of capital expenditure was financed by international donors, and almost half of total spending benefited investments. Compared to around 30 percent for most neighboring countries in the region, education spending in Lao PDR is tilted towards capital expenditures. While donors have started since 2002 to finance the recurrent costs implicit in their projects, there are concerns about inadequate domestic funding of recurrent expenditures once donor projects are completed. Otherwise, schools will be built but cannot teach well for lack of funds to pay teachers, buy textbooks, or carry out maintenance.

**About 40-50 percent of national education budget is allocated to recurrent expenditures; provincial figures vary significantly.** From 2002/03 to 2003/04, the share of recurrent spending increased from 40 percent to 53 percent, but the 2004/05 budget plan reverted to about 46 percent (Figure 11). However, the share of capital expenditures varies widely from one province to another and from one year to another. Investment in capital expenditures can also be erratic within the same province (Figure 12). For example, in 2002/03, Saravane spent 36 percent of its education budget on capital investments and Sekong spent 76 percent. The following year, Saravane spent only 4 percent of its education budget on capital investments and Sekong spent 33 percent. This reflects to a large measure the lumpiness and selectivity of donor funding,

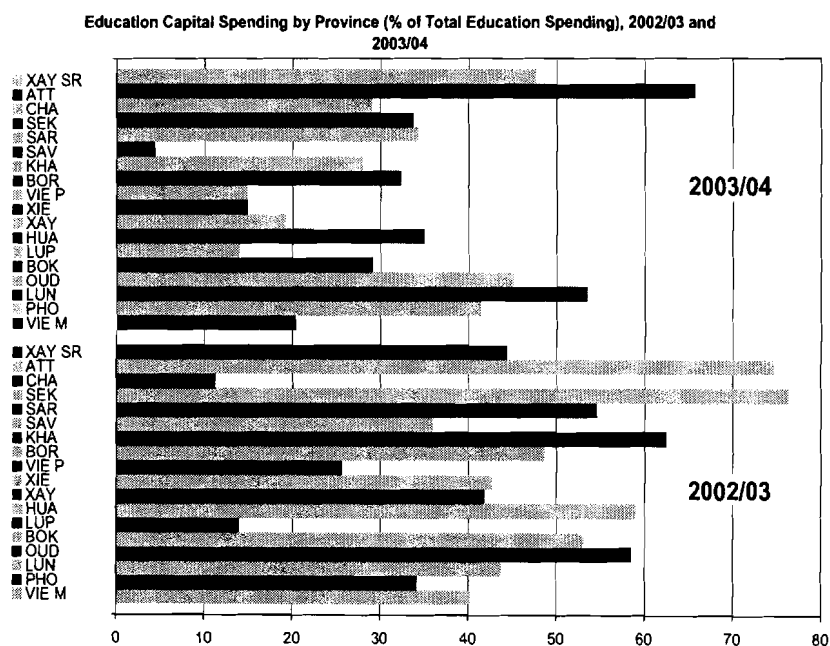
but it also raises question marks about the planning and management capacity at the subnational level.

*Figure 11: Reliance on foreign funding and a lack of domestic funds are associated with insufficient recurrent spending.*



Data source: Lao PDR Official Gazette.

*Figure 12: The share of capital spending as a percentage of total education spending varies by year and by province.*

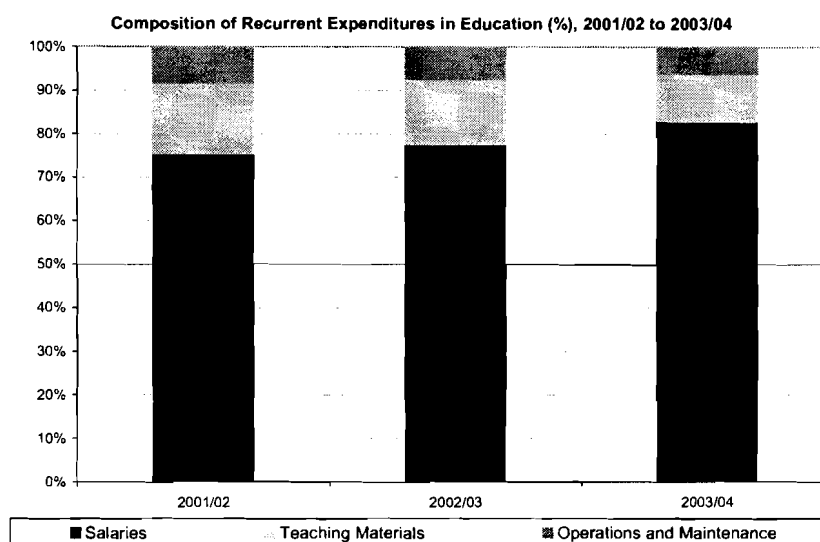


Data source: Lao PDR Official Gazette.

Within the small envelope of recurrent expenditures, budgetary resources are inadequate to cover salaries and operational expenditures. Although the share of teachers' salaries in recurrent expenditures increased in the early 2000s (Figure 13), the

level of teachers' salaries in Lao PDR remain low. Teachers' salaries average 390,000 kips, or 39 USD, a month. Salaries are approximately 130 percent of GDP per capita in Lao PDR, compared to an Asian average of 240 percent. Many teachers reported that they have to hold multiple jobs to supplement their incomes. However, an increase in the wage-bill has squeezed the already limited resources from non-wage spending. This situation has led to domestic arrears and to acute shortages of funds for routine operating expenses, including textbooks. There is remarkable variation in the allocation of recurrent budgets across provinces. In 2003/04, 15 provinces out of 17 spent less than the internationally recommended 33 percent on non-wage costs. Vientiane Municipality spent only 14 percent (Figure 14).

*Figure 13: Due to the small budget envelope for recurrent education spending, the rise in the share for salaries has squeezed operating expenditures.*



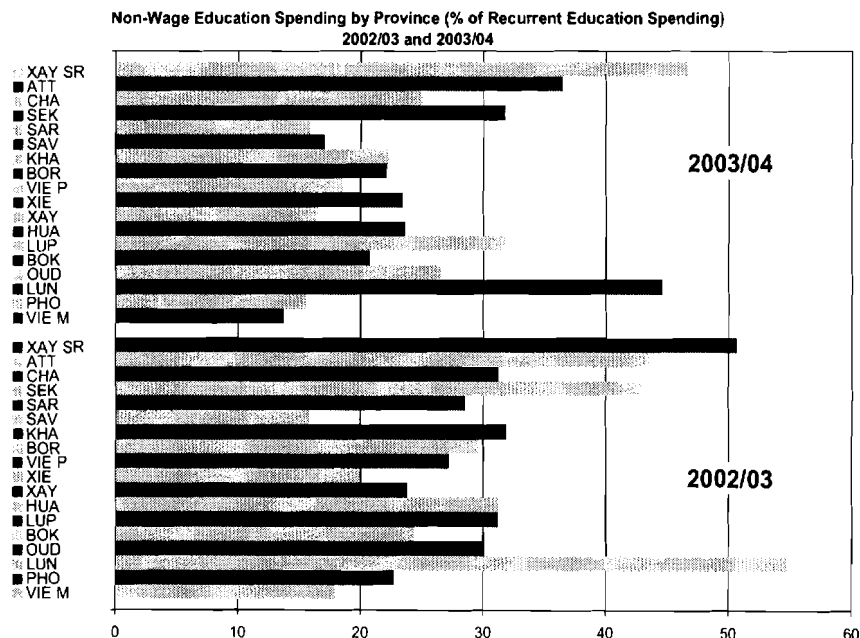
Data source: Lao PDR Official Gazette.

#### *4. Weak bottom-up process*

**Although the process works reasonably well at the provincial level, budget preparation at the district and school levels is weak.** This puts constraints on the bottom-up process. At the district level, only three out of five DEB received DFO guidance on their budget preparations before submitting their proposals to DFO. Three-fifths of the DEB submit their budget proposals quarterly; their annual proposals get revised anyhow. Similarly, only 43 out of the 55 DFO received guidance from PFO; 42 of them obtained a budget ceiling and received a DEB budget proposal. Fifty-one of them submitted their annual budget proposals to PFO. At the school level, budget preparation process is still weaker. Less than one-third of schools in 2005/06 submitted an annual budget proposal to DEB. Distance to DEB and the transportation convenience can be major reasons: more than two out of five schools in urban areas submitted proposals, compared to one out of four in rural areas; more than three out of five schools in urban areas discussed with DEB, compared to less than two out of five in rural areas

Figure 15). Just about one-half of the schools had discussions with the DEB after their budgets were approved. Again, there are wide disparities by areas: over three-fifths of urban schools met with DEB, compared to one-third of the rural schools without access to roads. Similarly, just one-quarter of the school directors knew whether the DEB had revised their 2004/05 budget proposal. The budget process works reasonably well at the provincial level—for example, in preparing the 2005/06 budget, all PFO provided guidance to PES; in 15 out of 17 provinces, the PFO indicated a budget ceiling to PHO and PES. All PFO submitted their budget proposals to the MOF for approval, and the MOF provided guidance to all PFO. The MOF also gave a budget ceiling to 16 out of 17 PES. All PFO submitted their budget proposals to the MOF for approval. However, the weakness at the frontline and district level lowers the overall effectiveness of budget preparations.

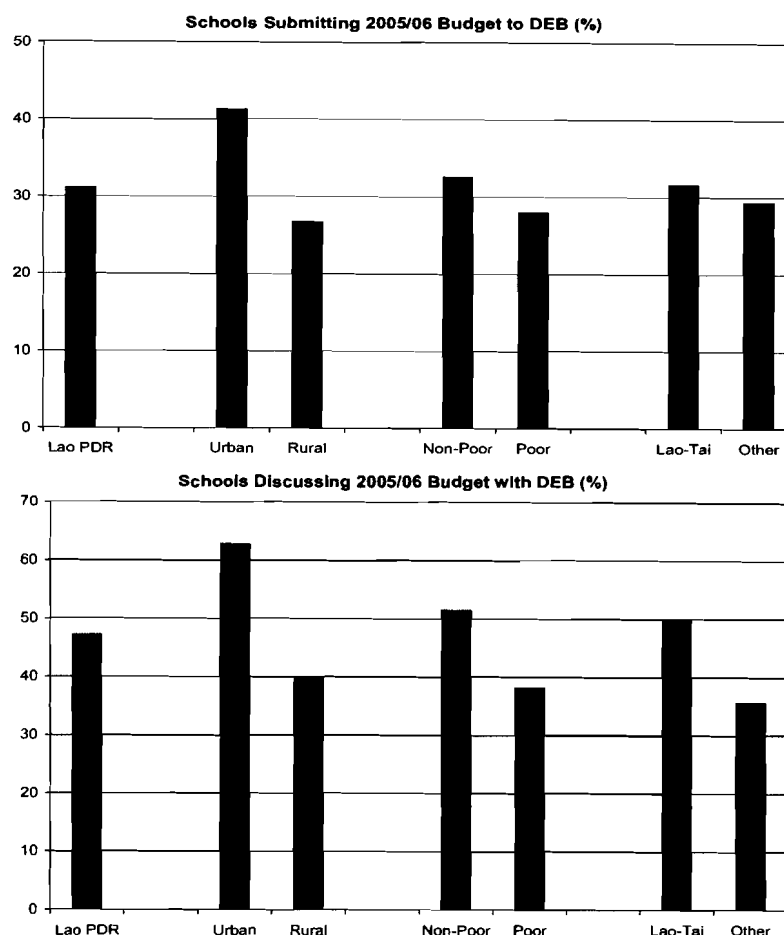
*Figure 14: The share of non-wage spending as a percentage of total recurrent education spending varies widely across provinces.*



Data source: Lao PDR Official Gazette.



Figure 15: Schools in less well-off areas participate less in budget preparations.



Data source: PETS.

### 5. Compressed Budget Cycle

**An overly compressed budget preparation cycle weakens the budget's effectiveness.** Budget preparation runs only from May to September. Provinces receive their target revenues and expenditure envelopes in June, and submit their budget outlines in July. This leaves almost no time for dialogue among the Ministry of Finance, sector ministries, and provinces. Budgets are often published late, and the structure and coverage of both the budget and end-year accounts is deficient. The National Assembly approves only a very high-level budget plan of two pages ahead of the fiscal year start date October 1st, and budget details are not finalized until February and are not published until near the end of the fiscal year or even after it is over.

### Execution and Reporting

**Budget execution and reporting systems need to be improved.** Treasury offices at each level of GOL lack of authority. Formally, the treasury offices at provincial level are departments of the central treasury and report both to the director of treasury and to the

provincial governor. In practice, the provincial governor has much greater influence over the provincial treasury office, not least because the staff is hired at the provincial level. The provincial governor has also a strong influence on provincial education officers. For example, in case of a funding deficit during the year, 15 out of the 17 PES would send a request to the provincial authority, compared to only 12 to the PFO. The governor's influence appears less pronounced at the district level. Out of 53 DEB, 35 would request additional funds in case of funding shortfall from PFO, 12 from PES, 3 from DFO and 3 from the district authority. However, most DEB that face financing shortfalls for salaries turn to the provincial governor for additional funding.

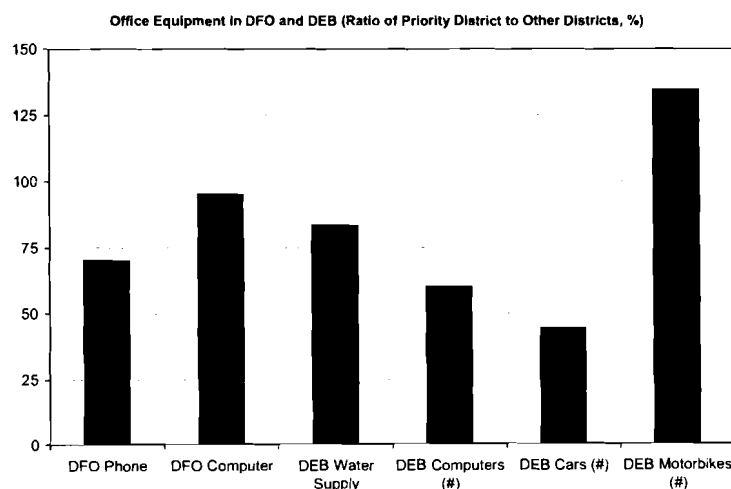
**The financial accounting and reporting systems of the treasury department of the Ministry of Finance are weak.** Until 2005, treasury reports have been almost entirely paper based, with provincial information available late if at all. The lack of automation, together with the lack of agreement on a reporting format, made it difficult to generate regular, timely, and accurate reports on budget execution. By early 2006, all PFO were equipped with computer, telephone and fax, and all but one had a software program for accounting. Still, only one PFO sent its reports to MOF by email, and 12 PFO used fax. Nine in 17 PFO report to MOF only on a monthly basis, and another 2 even less frequently. The situation was worse at the district level. Some 10 percent of the DFO did not have computers. Overall, one in five DFO used a software program for accounting, but none of the DFO in priority districts. While all but one DFO receive PFO supervision visits, they occur no more often than every four months in 23 DFO out of 54 DFO, and 5 DFO report their financial situation to the PFO only on a less than monthly basis. Currently, the new Treasury Budget System is being rolled out over the country under the management of treasury department of the Ministry of Finance. This system uses a single, standard Chart of Accounts (COA) and budget nomenclature. It is an integrated computerized network system that currently links 39 line ministries, 18 provincial treasury offices, four provincial tax offices and 17 customs offices. While this is a very positive development, the COA should both be simplified and extended, as they do not allow a functional breakdown. The current system does not allow separating spending at the primary level from other levels.

**The accounting and reporting systems in PES and DEB are ineffective when it comes to accountability.** All PES own computers and telephones, but only three-fifth could communicate via email with PFO or the MOE. While all PES keep accounting records and issue reports, they use different formats and guidelines according to instruction from MOE, MOF, or PFO. Only four out of five DEB have computers, and nine in ten rely on telephone to communicate with PES, DFO or MOE. All DEB keep records; however, just 49 out of 55 DEB surveyed produce accounting reports and just six of them release these reports to the public.

**Weaknesses in the budget process and financial accounting and reporting have much to do with the lack of human and material resources in provincial and district offices.**

- At the provincial level, PES has on average 41 staff, or around one staff per 40 primary teachers. Overall, staff increased in the last five years in two-thirds of the PES, but in deficit provinces it was only one out of two. In surplus provinces, three quarters of the staff interviewed have at least 15 years of education, compared to only two-fifths in deficit provinces. All PES have electricity, water supply and toilets, and—as a major change over the last five years—computers. Partly due to donor projects, PES in surplus provinces are better equipped than PES in deficit provinces with cars (6.3 versus 5.0) and mobile phones (4.3 versus 3.7). PFO employs on average 226 regular staff and 39 contract workers. Staffing is in per capita terms around 10 percent higher in surplus provinces than in deficit provinces. All PFO have telephones, computers, and faxes.
- At the district level, DEB has an average of 23 staff, or around one staff per 10 primary teachers. This compares to around 25 staff, in addition to 10 contract workers, in DFO. Three-fifths of the DEB staff interviewed in non-priority districts have at least 12 years of education, compared to only one out of two in priority districts. DEB in priority districts are less well equipped than DEB in other districts (Figure 16). In non-priority districts, close to 90 percent of DEB have sanitary water supply, and an average of 1.5 computers, 0.43 cars, 6.7 motorbikes; in priority districts, no more than 75 percent have sanitary water supply, and an average of only 0.9 computers, 0.19 cars, but more motorbikes (about 9.0 in average).

*Figure 16: DFO in non-priority districts are better equipped than those in priority districts.*



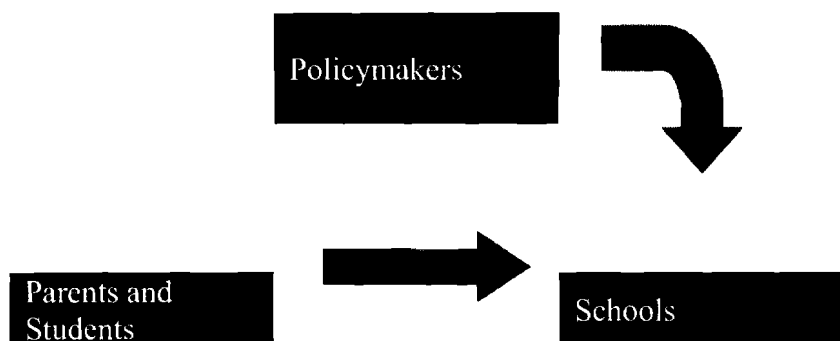
Data source: PETS.

## Frontline Services

**Making efficient use of funding at the frontline level is critical to the effective delivery of educational services.** How well teachers are paid and motivated, how well classrooms are equipped, and how well schools are accessible are keys as the ultimate objective of funding and expenditure management arrangement is to contribute to

learning in well-functioning schools with well-motivated teachers. This section elaborates on how parents/communities can complement the long route of accountability of schools vis-à-vis policymakers through direct accountability (Figure 17). From the perspective of schools, this section focuses on teachers' salary, operational resources, accountability, and school access and quality.

*Figure 17: The accountability of schools to policymakers and parents is crucial for education.*

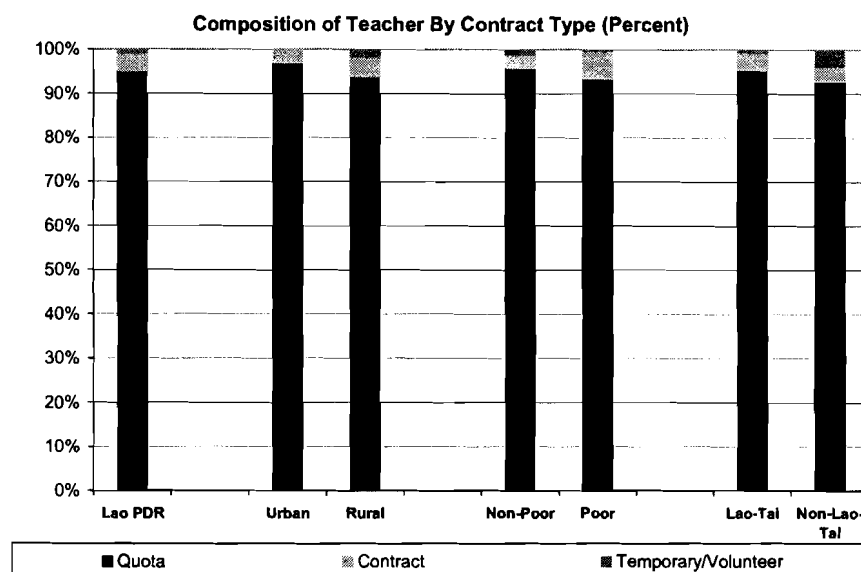


## Teachers

**Low salaries and frequent delays in salary payments are a major constraint on teachers' performance and the overall delivery of education services in Lao PDR.** PETS allows tracking the salary payments from DEB to the schools from the 1346 teachers working in the survey schools. No evidence from the survey suggests that salary leakage from the district level to the facility level or ghost teachers is a major concern; the system of teachers' salary payment is rather standard; but inadequacy of resources remains a key bottleneck.

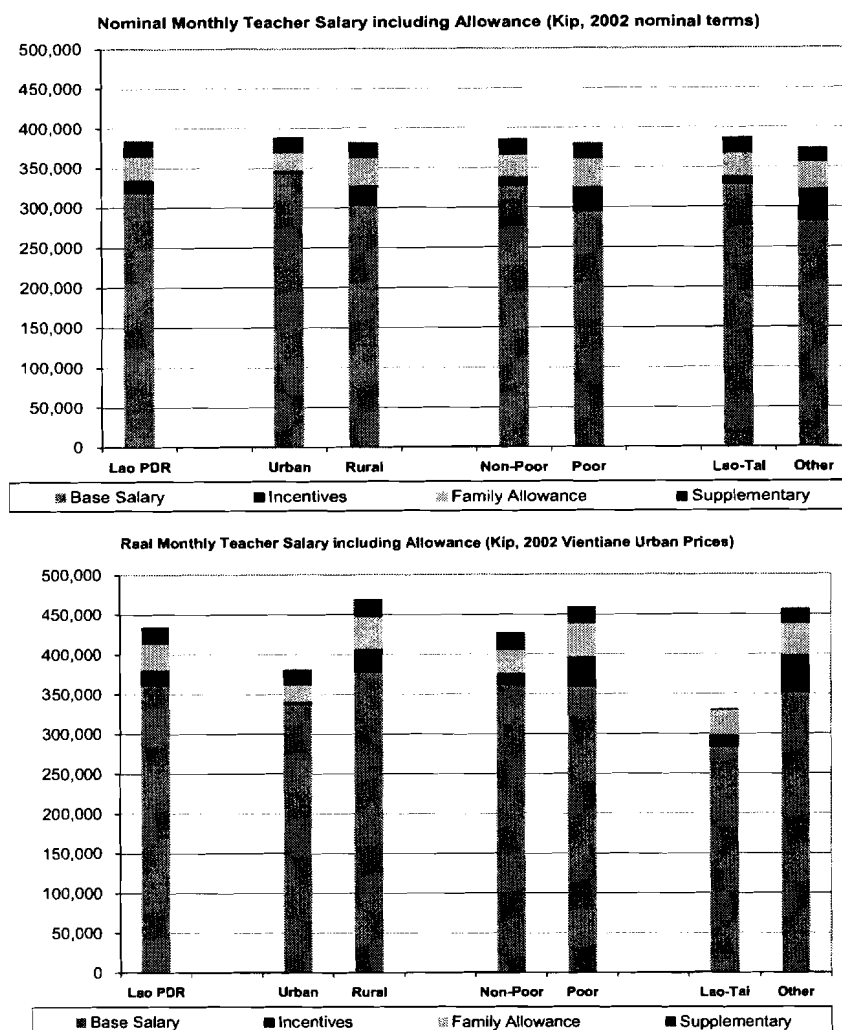
**In Lao PDR, about 95 percent of the teaching profession are civil servants; just a handful are contract or temporary/volunteer teachers (Figure 18).** Such ratio does not differ much in less well-off areas and in well-off areas. Quota teachers are regular civil servants; contract teachers receive salaries in line with the government's pay-scale but do not receive the social security benefits; temporary/volunteer teachers are usually hired by the community at negotiated wages, which are lower than those of quota teachers.

Figure 18: More than nine out of 10 teachers are quota teachers.



**In Lao PDR teachers' salaries are low.** In absolute terms, average overall monthly salary is around Kip 390,000, or 39 USD. Kip 320,000 is the base salary, and Kip 70,000 is bonuses, family allowance, and supplements. In relative terms, teachers' salaries are around 130 percent of GDP per capita, which is low based on international standards. In many East Asian countries, teachers' salaries are about two and a half times GDP per capita as teachers are better educated relative to average workers. The level of teachers' overall nominal salary is similar in different areas (Figure 19). While the better qualification of teachers in urban areas lead according to the government pay-scale to a higher base salary than in rural areas, the difference is roughly compensated by higher incentives and family allowances for teachers working in remote and less well-off areas. For example, close to four in five schools in non-Lao-Tai villages pay benefits to teachers for multi-grade teaching, compared to only two in five schools in Lao-Tai villages. In real terms, since life is cheaper in less well-off areas, salaries are higher there.

*Figure 19: Salaries vary little in nominal terms; they are higher in less well-off areas in real terms.*



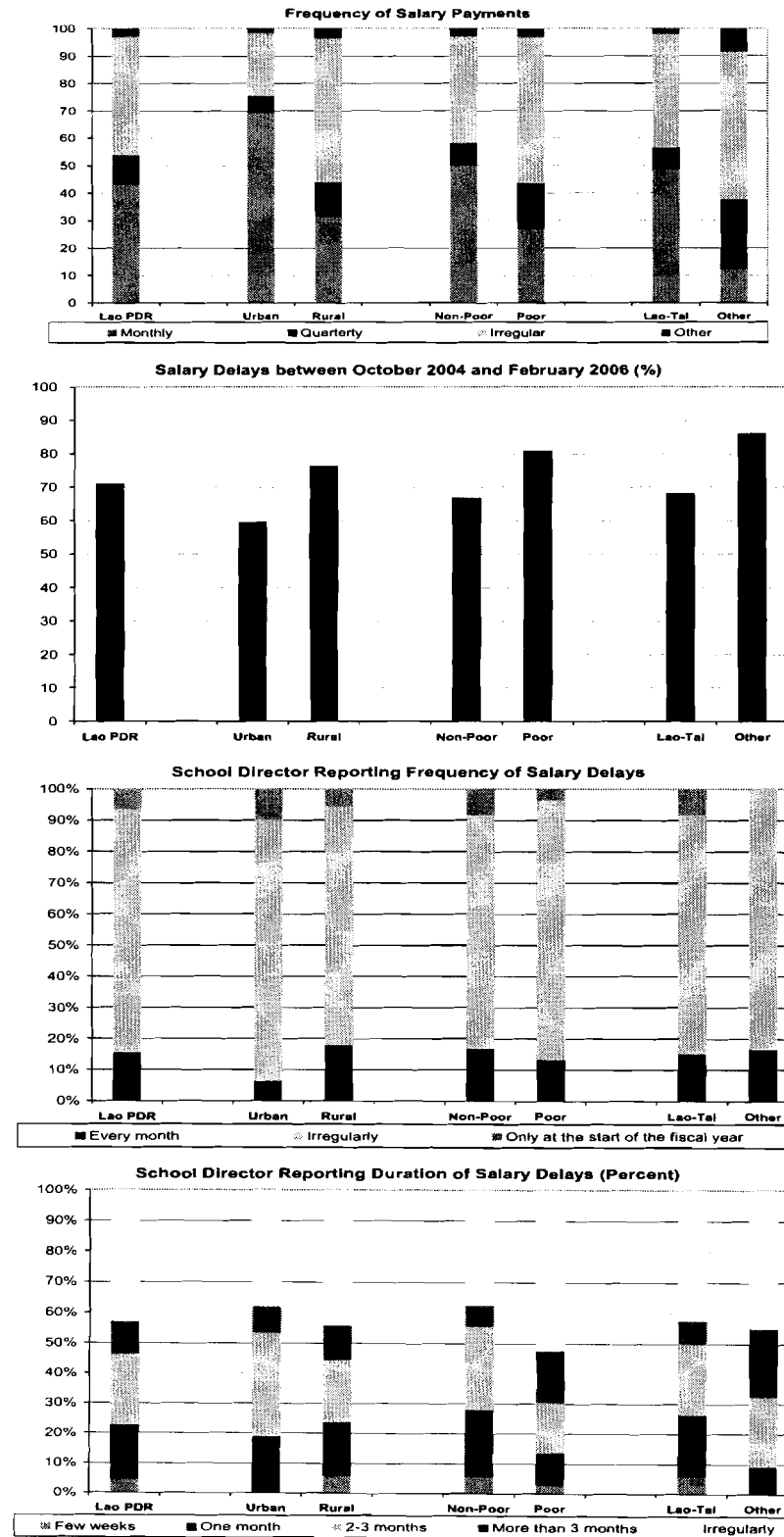
Data source: PETS.

**The delays in payment of teachers' salaries are serious, particularly in less well-off areas.** The data from Ministry of Education suggests in the last quarter of FY05 and the first quarter of FY06 the GOL has paid out the salaries of teachers such that the stock of salaries outstanding more than 1 month came below 6 percent of a month's payroll; and that severe arrears in salaries (over three months) have been eliminated (World Bank, 2007a). However, the PETS results indicate a less favorable picture.<sup>5</sup> In Lao PDR, less than 50 percent of teachers are paid on time every month, almost 40 percent teachers got paid irregularly. While salaries may have a greater purchasing power in less well-off areas, other aspects of the wage package are less appealing (Figure 20). First of all, salary payment is less frequent. For example, the survey suggests that while 70 percent of teachers get paid monthly in urban areas, this is just over 30 percent in rural areas. In

<sup>5</sup> The numbers are not directly comparable. Discrepancies in salary payment between different sources of information can come from, for example, sampling and timing.

particular, over one in two teachers in rural areas, poor villages or non-Lao-Tai localities receive wages irregularly. Overall, 70 percent teachers had experienced salary payment delays in the past year and a half. Salary arrears are more often in less well-off areas: six out of seven teachers in non-Lao-Tai villages had their salaries delayed at least once since October 2004. One in two school directors in urban areas report paying salaries on time, compared to only one out of four in rural areas. About eight percent of teachers' salaries are delayed every month in cities compared to 18 percent in villages. While five percent of the delays last three months in urban areas, the number doubled to about 10 percent in rural areas. These findings are also confirmed at the district and province level. DEB report that only one out of ten salaries is paid every month on time in priority districts, compared to almost one out of four in non-priority districts. PES state that less than one out of ten salaries are paid every month on time in deficit provinces, compared to two out of five in surplus provinces. Given the problems of low and infrequent payment, it is little wonder that only five percent of teachers interviewed say that their salary is sufficient to cover living expenses.

Figure 20: Salary payment delays are more serious outside of cities; most teachers have experienced salaries arrears in the past.



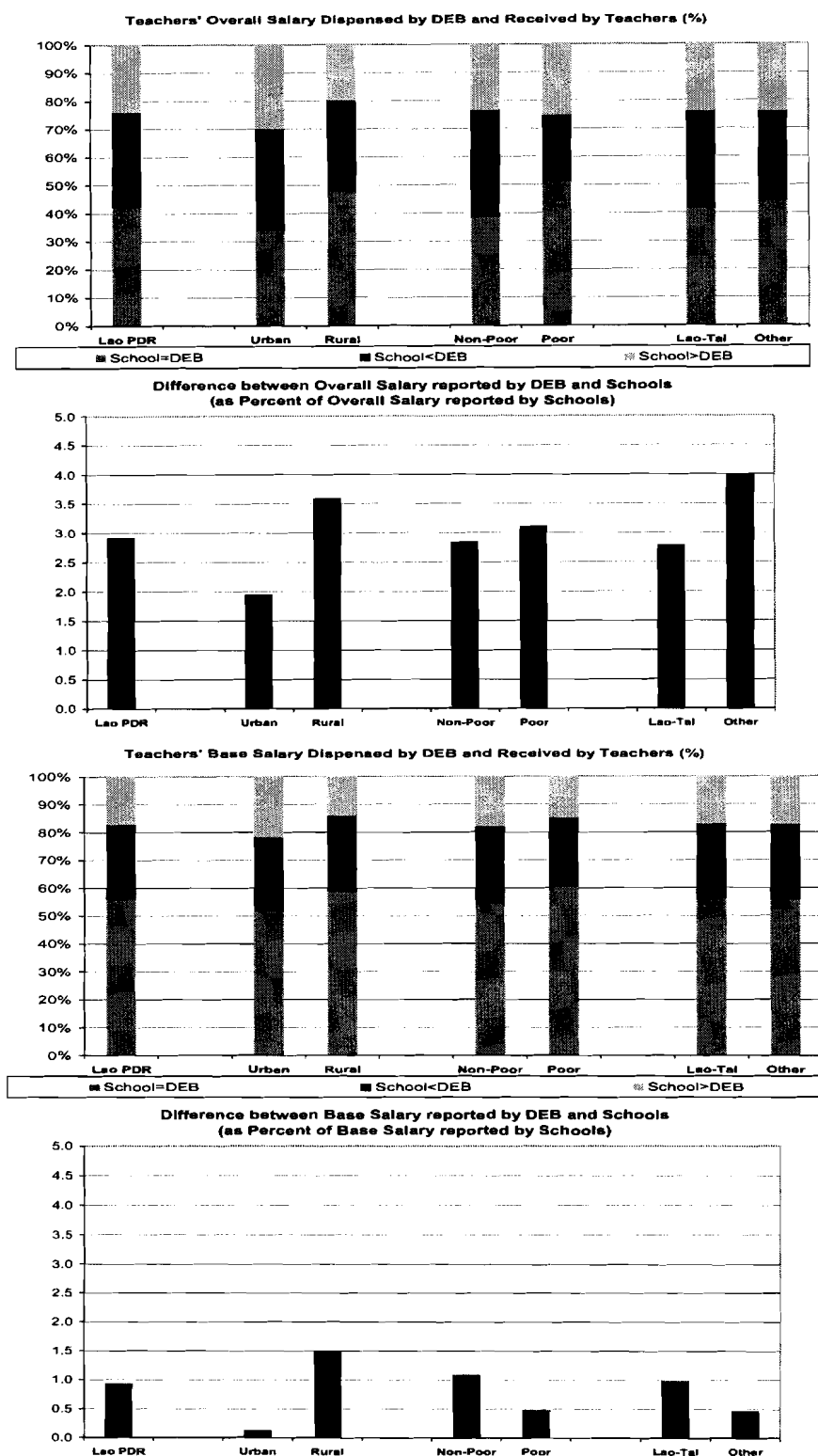
Data source: PETS.



**The survey results suggest that the system of salary payments is standard.** However, the system itself is not a major factor in the delays of salary payments. In most cases (over 80 percent), school director collects the teachers' salaries from DEB in return for signing a DEB's registration form, and hands out the salaries to the teachers, once again in return for them signing a receipt form. Only in some five percent of cases no receipt forms are signed by either school director or teachers. Virtually all salaries (97 percent) are paid in cash. In the other cases, school director receives the salaries from DFO, or DEB itself delivers the salaries to school, or some other arrangement is in place. However, in remote areas without road access, travel to the DEB takes time and is costly. Almost one out of four schools pay a fee for a messenger to fetch salaries from DEB every few months rather than every month. Anecdote suggests that the fee for messenger to cover transport costs can be as high as one-third of a teacher's salary. This also can be an important factor that leads to salary payment delay, in particular in remote areas.

**There is little evidence to suggest that salary leakages between DEB and schools are a major concern.** Deviations in the amount of salary payment occur in both directions; however, average difference is small between what is reported at the district level and what is reported by school (Figure 21). For overall salaries, the DEB and school reports coincide exactly for about two out of five survey cases; the DEB reports lower payments than the school for about one out of four survey cases; and DEB reports higher payments than the school for about one out of three survey cases. The average difference between payments reported by DEB and school is less than three percent of the school reported overall salary. When we consider teachers' base salary only, then over 55 percent of salary reports coincide exactly between DEB and the school, and the average gap is no more than one percent of the school reported base salary. There does not appear to be a systematic salary leakage at a significant scale between DEB and schools. These findings confirm the impression obtained during the preparatory qualitative field work for the PETS. They also match the findings from a nationally representative survey conducted in May/June 2006 in Lao PDR, which suggests that salary leakage of secondary school teachers is low—among the 155 lower secondary schools surveyed, 58 percent of teachers responded that they paid a small "facilitation fee", which amounted on average to 11,000 Kip out of a 437,000 Kip payment or 2-3 percent in relative terms, to receive their salaries (World Bank 2006e).

Figure 21: Differences in teachers' salary payment are small between reported by DEB and schools

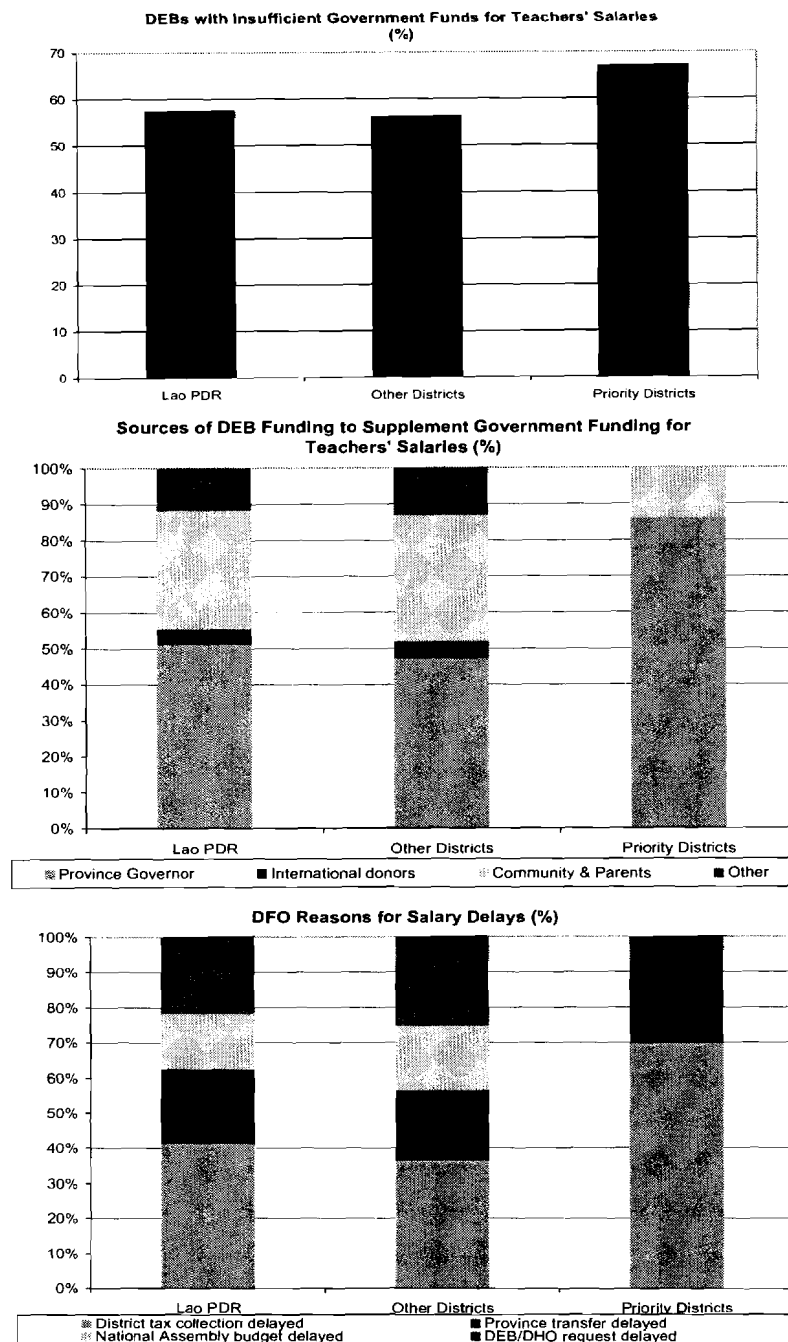


Data source: PETS.

**There is also no evidence of widespread ghost-teachers.** The survey suggests that only 16 out of 1360 names recorded in the DEB forms could not be matched to active teachers in schools; only 40 teachers registered on school records did not appear on DEB lists. These minor differences could reflect reporting discrepancies, time lags in the updating of teacher registrations in case of new appointments or promotions, or community volunteer teachers. Only one out of three schools report the number of teachers to DEB and DFO less frequent than every month.

**Insufficiency of funds is more likely to create a bottleneck that leads to delays in salary payments.** Teachers' salaries are supposed to be fully covered by central budget. However, more than 50 percent of DEB reported government funds are insufficient for teachers' salaries; and the number is almost 70 percent for DEB in priority districts (Figure 22). When facing insufficiency of resources, overall about 50 percent DEB rely on funds from the provincial governor and 30 percent rely on community and parents to make up the difference; however, the numbers are about 85 percent and 15 percent respectively for DEB in priority districts. Correspondingly, DFO are also faced with salary delays. Overall, two out of five DFO consider that one reason for salary delays is the delays in district tax collection; however, the number is about seven out of ten in priority districts. Discrepancies in timing of resource availability and relatively high transaction costs also contribute to salary payment delays, particularly in remote poor rural areas.

Figure 22: Funding shortage in DEB and DFO creates a bottleneck that leads to salary delays.

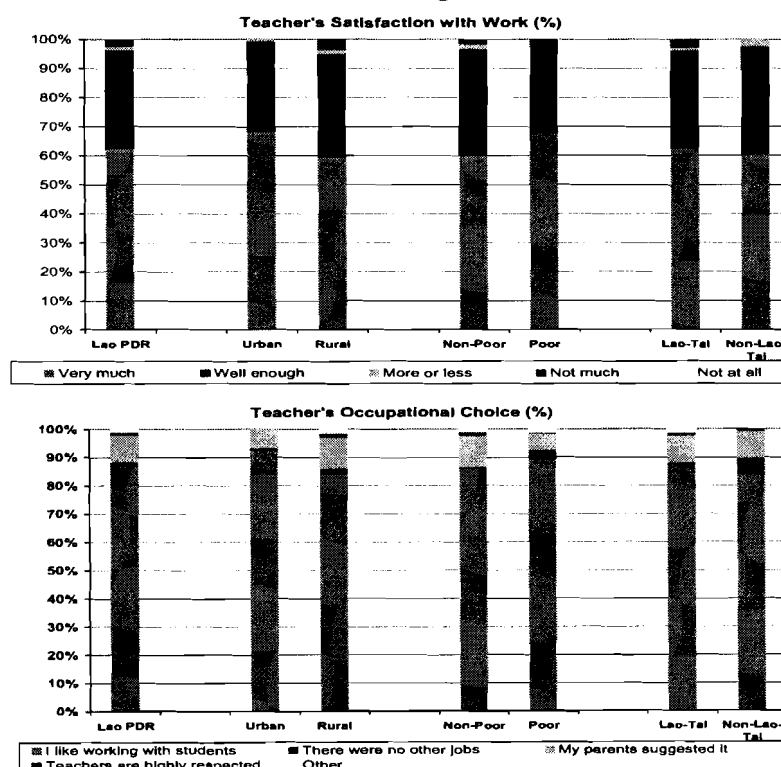


Data source: PETS.

Most teachers have high job morale despite their low salaries, frequent delays in getting paid, lack of training opportunities, and a heavy workload due to multi-grade teaching. The last was particularly true in rural areas. Nineteen out of 20 teachers surveyed reported they were satisfied with their overall work at school (Figure 23). Three factors may be in favor of a good education service delivery. First, many teachers, often the majority, are driven by an intrinsic motivation to serve. Be it through professional

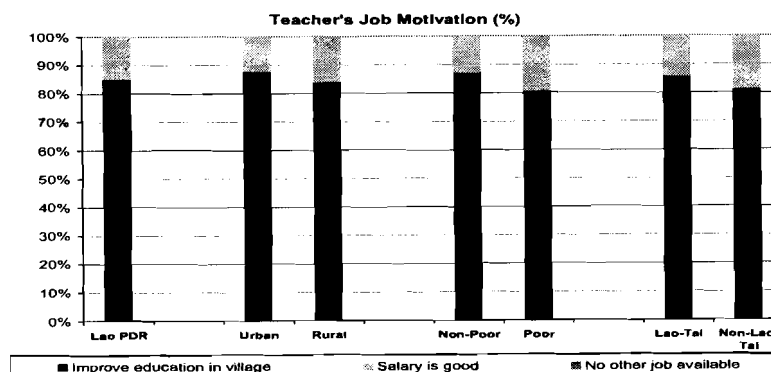
pride or a genuine commitment to help poor people (or both), many teachers are dedicated to deliver timely, efficient, and courteous services, often in difficult circumstances (Figure 24). Second, a higher share of female teaching staff may also have contributed to the equalization of enrolment rates. Third, most school directors and teachers work in their home village or districts, or know the local language (Figure 25) Even in non-Lao-Tai villages, only one out of sixth teachers does not speak the local language. This has clear advantages. Because local teachers know the local language and customs, they are likely to be better able to communicate with students and parents.

*Figure 23: In spite of the difficult circumstances, teachers like their work and became teachers for the right reasons.*



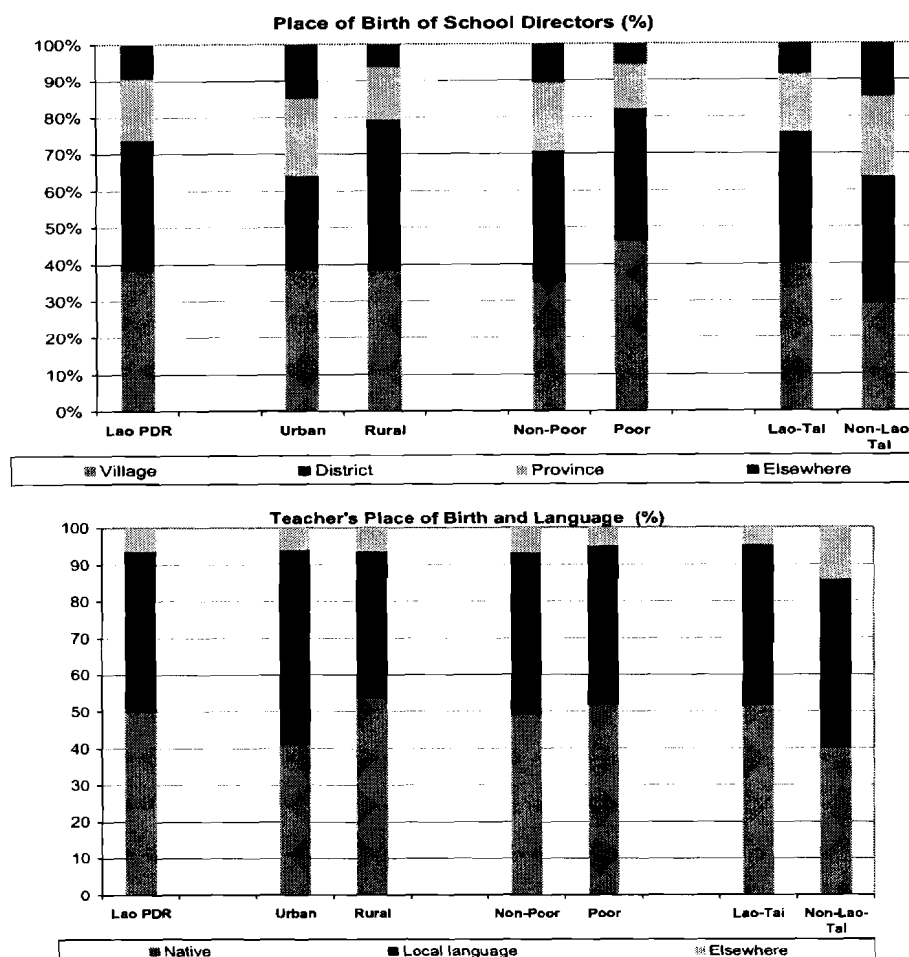
Data source: PETS.

*Figure 24: Teachers are dedicated to improve education service.*



Data source: PETS.

Figure 25: Most school directors and teachers are local or know the local language.

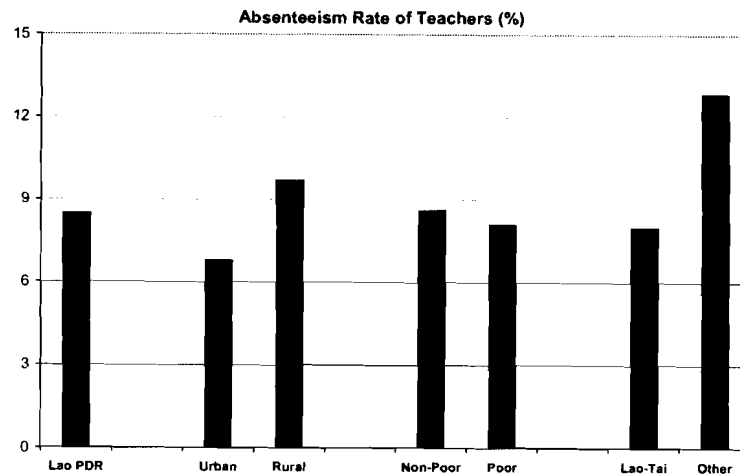


Data source: PETS.

**Teachers' absenteeism rate is low in Lao PDR.** Overall, just over eight percent of teachers in survey schools were absent at the time of an unannounced visit (Figure 26).<sup>6</sup> Absenteeism rate is slightly higher in rural areas (almost 10 percent) and in non Lao-Tai areas (about 13 percent), but still low compared with other developing countries where teachers' absence rates range from 11 percent (Peru) to 27 percent (Uganda) (Chaudhury et al., 2005). In addition, only about two out of five teachers who were absent from work were for reasons other than official reasons or sickness (Figure 27).

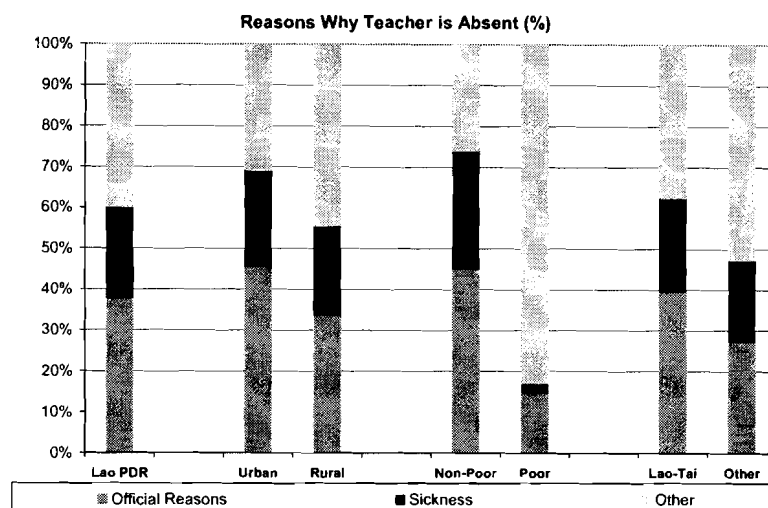
<sup>6</sup> However, most teachers live near schools (within a ten minute walking distance). The low rate of absenteeism may be an underestimate. Teachers who were not working at school at the time of the visit could come back to school to be "present" in a short time if notified.

Figure 26: Teachers' absenteeism rates do not appear to be high.



Data source: PETS.

Figure 27: About two out of five teachers who were absent from work were absent for reasons other than official reasons or sickness.

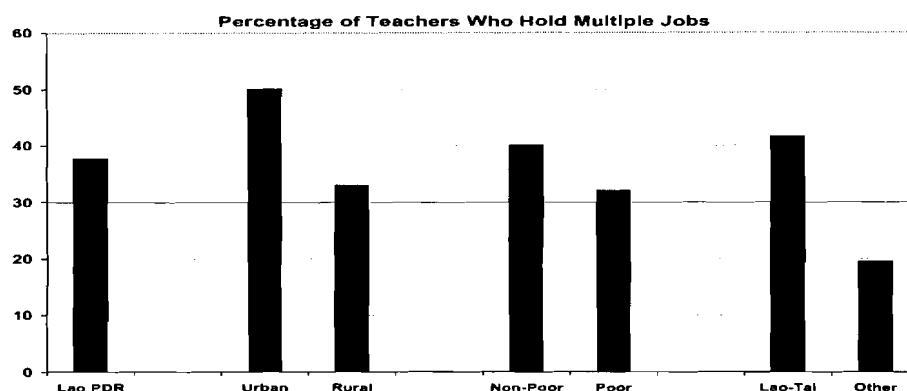


Data source: PETS.

**However, modest salaries and frequent delays in payment result in teachers' having to hold multiple jobs.** This negatively affects education service delivery. Overall, about one out of three teachers surveyed reported they hold multiple jobs. Multiple job-holding is more common in urban areas, non-poor areas, and Lao-Tai areas, partly because teachers' salaries there are lower in real terms and partly because teachers there are more qualified and may have better opportunity to find secondary (or tertiary) job to work on (Figure 28). Most teachers reported that they have to hold two or more jobs to make ends meet. Many secondary jobs, however, are agricultural jobs. For example, among teachers who are absent for personal reasons, four out of five are absent only at the busiest season for the farming. Although most teachers are eager to contribute to the community and have high morale in teaching, the low level of salary and frequency of salary delays does

affect teaching negatively. Multivariate analysis suggests that teachers with long and frequent delay are likely to spend less time on lesson-preparation and to be absent from work for non-official reasons.

*Figure 28: Teachers in urban, non-poor, and Lao-Tai areas are more likely to hold multiple jobs.*

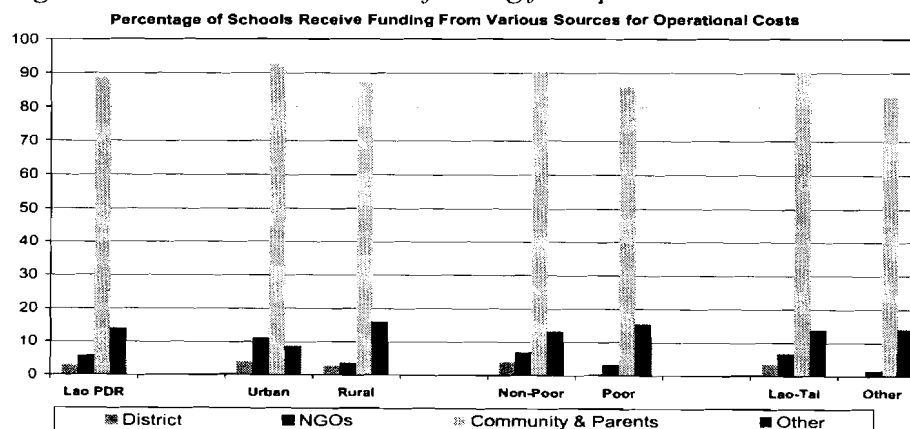


Data source: PETS.

## Operating funds and school quality

**The limited amount of resources for school operating costs is inequitably distributed.** Funding for teachers' salaries is supposed to come from the central budget. In contrast, funding for operating costs, such as equipment, textbooks, and teaching materials, mainly comes from resources that schools and DEB can mobilize. Nine out of 10 schools raise revenues from parents and communities. As a result, the economic circumstances of the locality directly impact the school's finances (Figure 29). Schools in less well-off areas are more likely to face tighter resource constraints than schools from well-off areas. For example, operating revenues for schools in rural, poor, and non-Lao-Tai areas is between Kip5,000 to Kip15,000 per student. For schools in urban, non-poor, and Lao-Tai areas, it is close to Kip 50,000 per student (Figure 30).

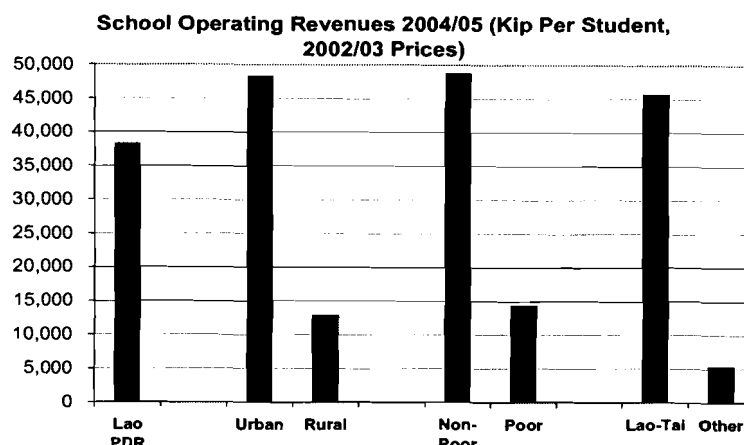
*Figure 29: Most schools receive funding from parents and communities.*



Data source: PETS.



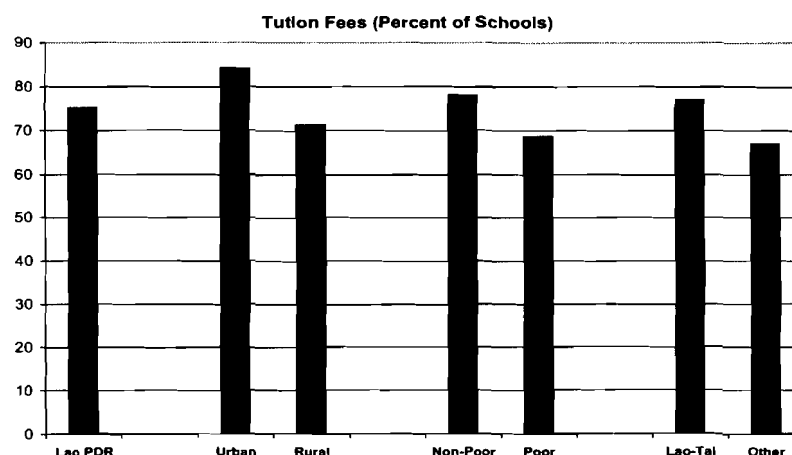
*Figure 30: Schools in well-off areas can mobilize more resources than schools in less well-off areas.*



Data source: PETS.

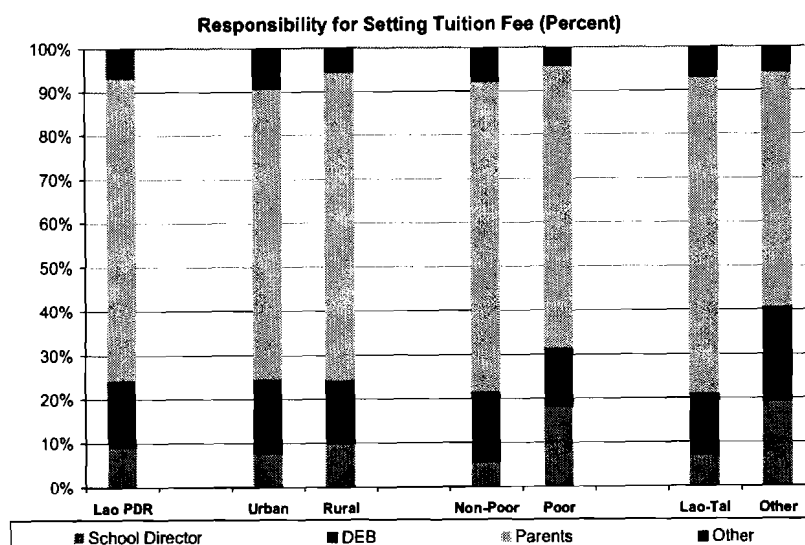
A large part of the difference is accounted for through the collection of tuition/registration fees. Three out of four schools in Lao PDR collect such fees (Figure 31). In over two-thirds of the cases, parents are in charge of setting the fee (Figure 32). Although tuition/registration fees stand for a larger percentage of resources covering operating costs for schools in less well-off areas, schools in less well-off areas are less likely to be able to collect such fees and the absolute amount collected per student there is much lower than that in well-off areas (Figure 33). Tuition/registration fees are typically collected at the beginning of the school year, and on average increased from Kip 13,000 in 2003/04 to Kip 17,000 in 2004/05 per student (2002/03 prices). According to the survey, almost universally, such fees are not used to prop up teachers' salaries, but instead to purchase teaching materials, fund renovations etc.

*Figure 31: Three out of four schools collect tuition/registration fees.*



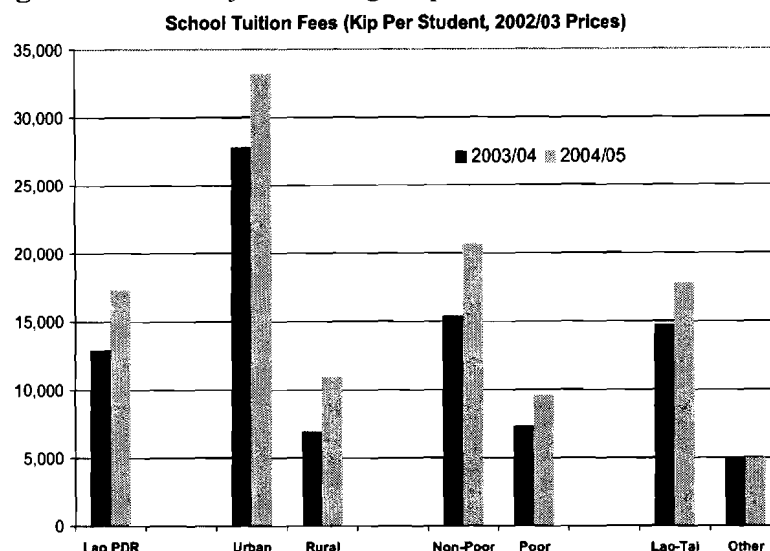
Data source: PETS.

Figure 32: In over two out of three cases, parents are in charge of setting tuition fees.



Data source: PETS.

Figure 33: Tuition fees are higher per student in well-off areas.

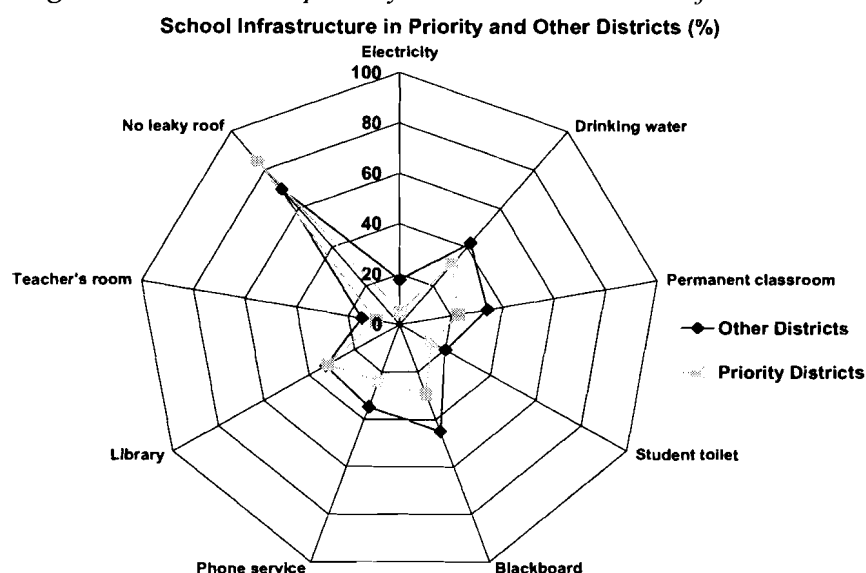


Data source: PETS.

Many students, especially those in less well-off areas, do not have good access to primary schools with a complete cycle of grades. According to LECS, in 2002/3, one out of six families had to send their children to neighboring villages for education. According to the 2005 Population Census, only four out of five villages have primary schools. While some villages have no schools at all, other have only incomplete primary schools. Due to the small number of children, lack of teachers or limited facilities, some primary schools offer only the first two or three grades. According to LECS 2002/03 and Lao Population Census (2005), about one out of three villages had complete schools. The percentages are especially low for the poor, priority districts, and non-Lao-Tai ethnic groups.

**Many schools, especially those in less well-off areas, do not have adequate basic facilities.** Figure 34 portrays the infrastructure characteristics of the primary schools in 2002/3. Some of these attributes, such as the share of classrooms with a blackboard and the presence of a school library, are directly related to pedagogical processes, while others may affect instruction and learning mainly through making the school more comfortable for students (e.g., availability of drinking water, a toilet for students) and for school personnel (e.g., availability of a principal's office, teachers' room). Less than 10 percent of schools in priority districts have electricity, compared to about 20 percent in non-priority districts. In most aspects (except library and no-leaky roof), facilities in schools in priority districts are in worse condition than those in other districts. Similarly, schools in poor areas and non-Lao-Tai areas are less well-equipped than those in non-poor areas and Lao-Tai concentrated areas, although the differences are less pronounced than across priority and non-priority district categories.

*Figure 34: Schools in priority districts have worse infrastructure.*

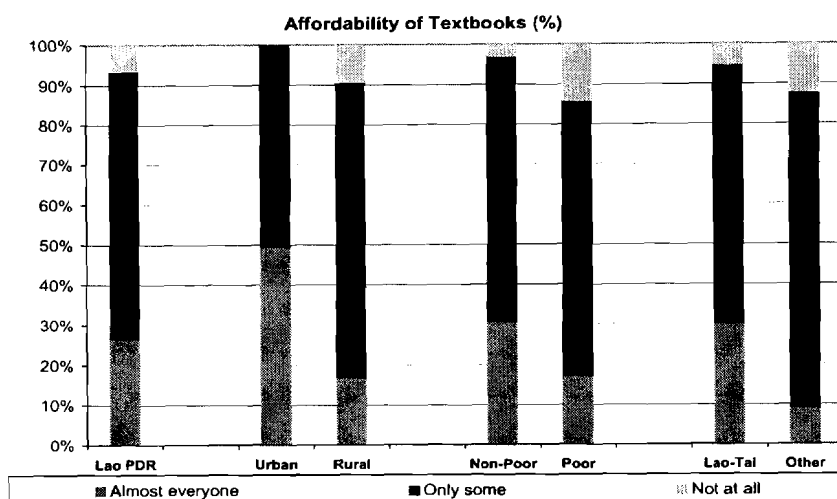


Data source: PETS.

**The lack of student textbooks is a big concern throughout the country.** Students from less well-off areas face more constraints. On average, two students have to share one textbook. The situation is slightly better in urban areas, where three textbooks are divided among five students, and worse in non-Lao-Tai communities, where one textbook is shared among three students. It is not surprising that non-Lao-Tai villages fare poorly in terms of teaching materials. The last time schools received textbooks was about 7 ½ years for teaching guides, and close to six years for textbooks. DEB provide close to three-quarter of the teaching materials, and, as we have already seen, they function less well in remote areas. In one out of six non-Lao-Tai villages, there are no textbooks sold at the market, compared to one out of twenty elsewhere. And if they are available, in non-Lao-Tai village less than one out of ten children can afford to buy textbooks, compared to close to one out of three in Lao-Tai villages (Figure 35). The provision of teaching guides is better for grades one to grade four. Most schools provide

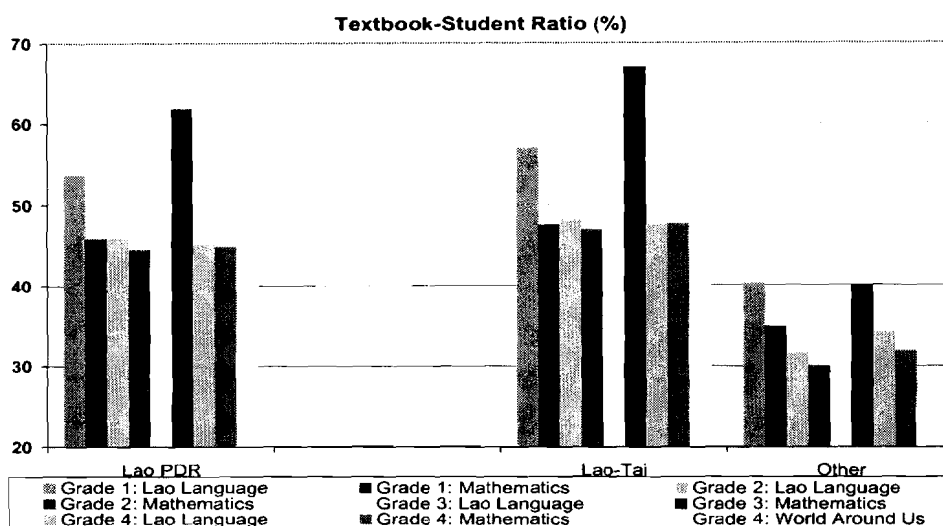
teaching guides on Lao Language, Mathematics and The World Around Us to each teacher. The textbook to student ratio in non Lao-Tai areas is lower than those in Lao-Tai areas (Figure 36).

*Figure 35: Many students cannot afford textbooks.*



Data source: PETS.

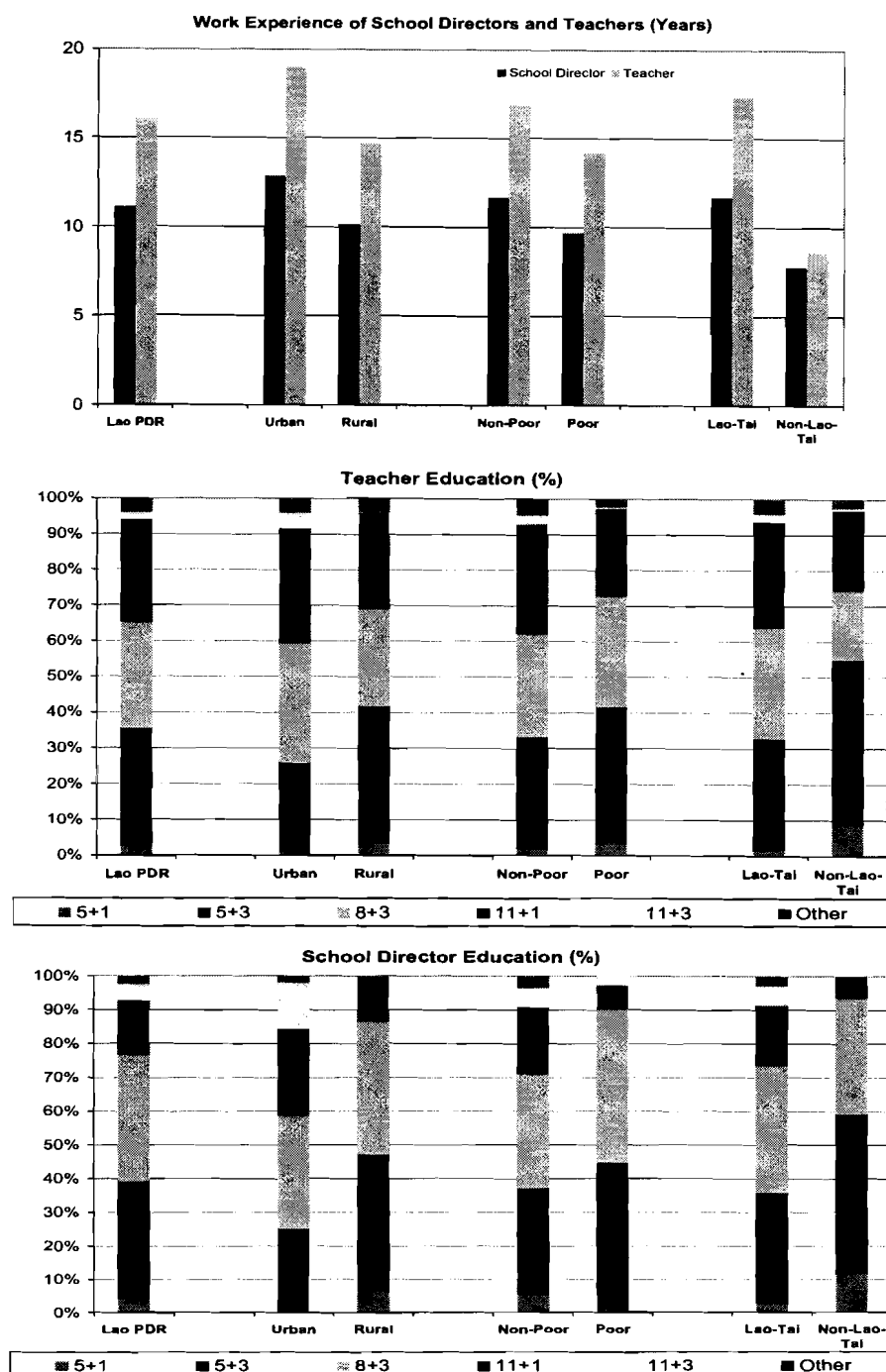
*Figure 36: Non-Lao-Tai villages have fewer textbooks than other villages.*



Data source: PETS.

**Teachers' education and experience are important indicators of school quality.** Teachers in well-off areas are in average better qualified. The variation in the education and experience profile of teachers and schools directors is pronounced (Figure 37). Overall, teachers have about 16 years of experience and school directors have about 11 years. In Lao-Tai localities, two out of three teachers have completed upper secondary education; compared to less than one out of two in non-Lao-Tai villages. The gap is wider for school directors: two out of five have post-upper-secondary education in cities, and about one out of eight in villages.

Figure 37: Teachers and school directors in well-off areas are better educated and more experienced.

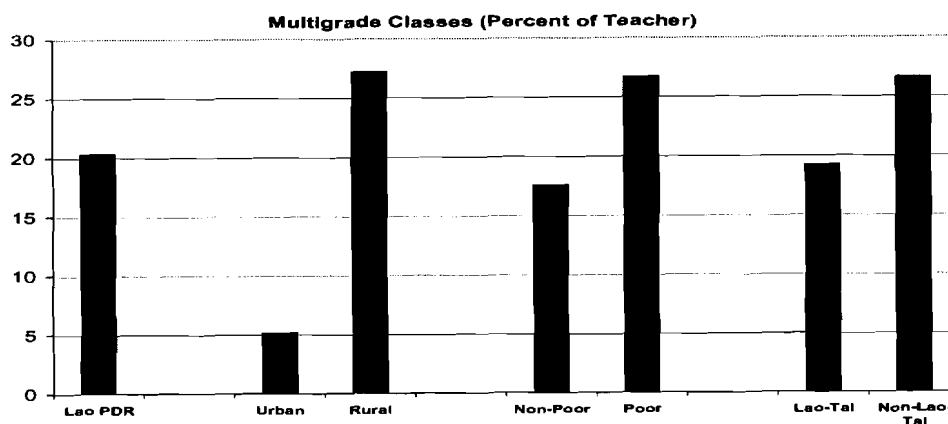


Data source: PETS.

**Multi-grade teaching is more prevalent in rural areas, but teachers there are not as well trained.** Many teachers who find themselves in a multi-grade environment, however, are either untrained or trained only in monograde pedagogy and have few teaching resources or learning resources. While only one out of 20 teachers in urban areas instructs multi-grade classes, one out of four teachers in rural areas have to do so

(Figure 38). Multi-grade classes arise through necessity rather than choice. Parents in rural areas often face the choice between sending their child to a school with multi-grade or to leave the child uneducated.

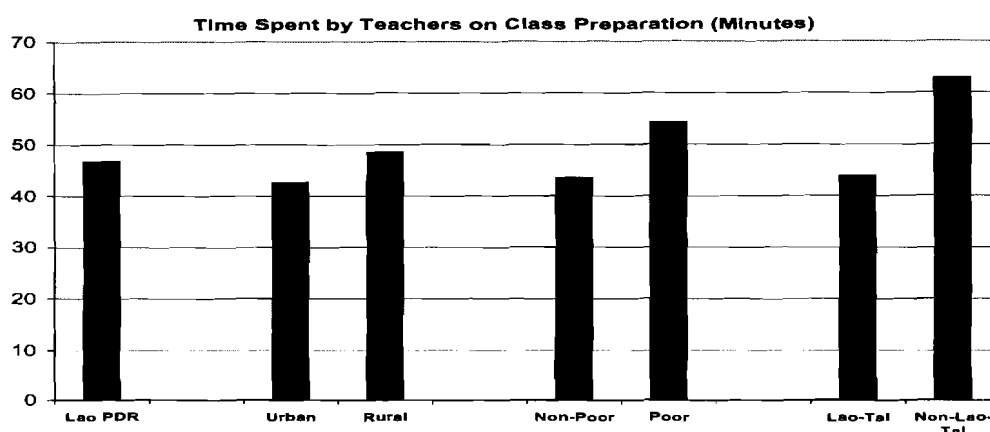
*Figure 38: Multi-grade classes are common in less well-off areas.*



Data source: PETS.

**Teachers' demand for professional training is largely unmet.** Nineteen out of 20 teachers surveyed reported they would like to receive more training to improve teaching skills and to meet other teachers and exchange information. Only about one out of two teachers attended a teacher training during the last 15 months, about half of which offered by PES or DEB. Teachers show remarkable effort in getting ready for instruction. In average, teachers in Lao PDR spend 45 minute to prepare for each class; teachers in less well-off areas spend even more time partly because they face more teaching difficulties, such as multigrade teaching; partly because they may have less education or experience (Figure 39).

*Figure 39: Teachers spend on average 45 minutes to prepare for each class.*

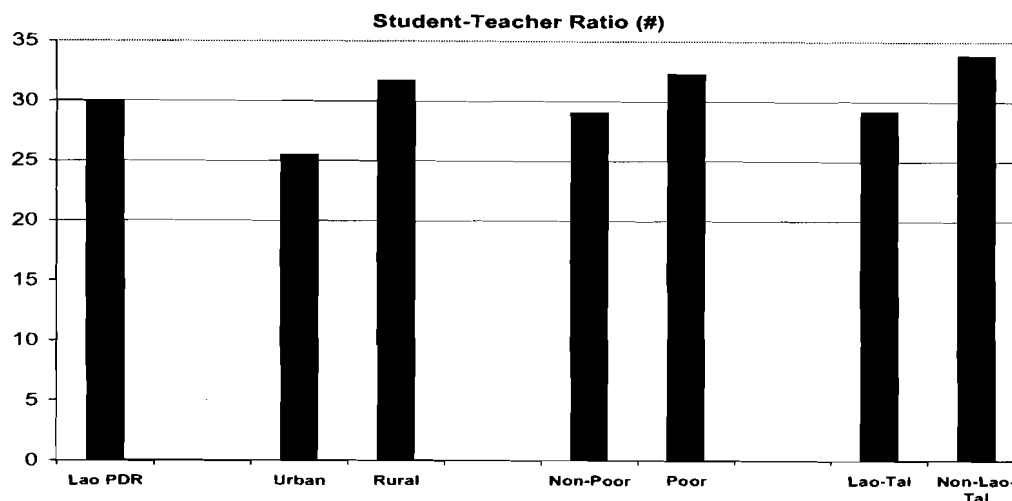


Data source: PETS.

**The supply of teachers is greater in urban areas than in rural areas.** Less well-off areas face more severe constraints of teacher shortage (World Bank, 2007b). Overall, the average pupil-teacher ratio for primary schools is about 30 to one (Figure 40). The ratio

ranges from around 25 to one in cities to 34 to one in non-Lao-Tai villages. This is a remarkable variation in view of the official government policy that allocates an additional teacher to a school when it enrolls another 33 students. The difference emerges largely on account of demographic trends—while fertility rates have come down sharply in urban areas, they have remained high in rural areas—and the inadequacy of the quota system to allocate teachers to less well-off areas.

*Figure 40: Student-to-teacher ratios are higher in less well-off areas than in well-off areas.*



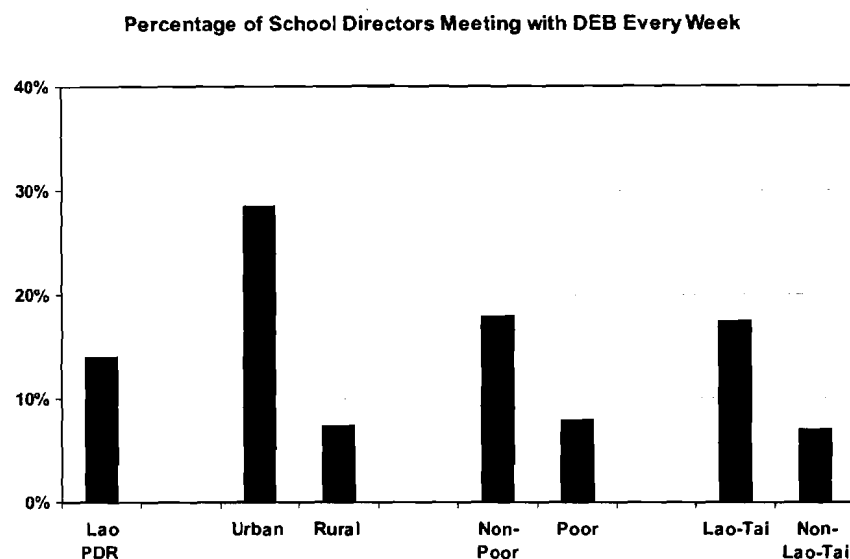
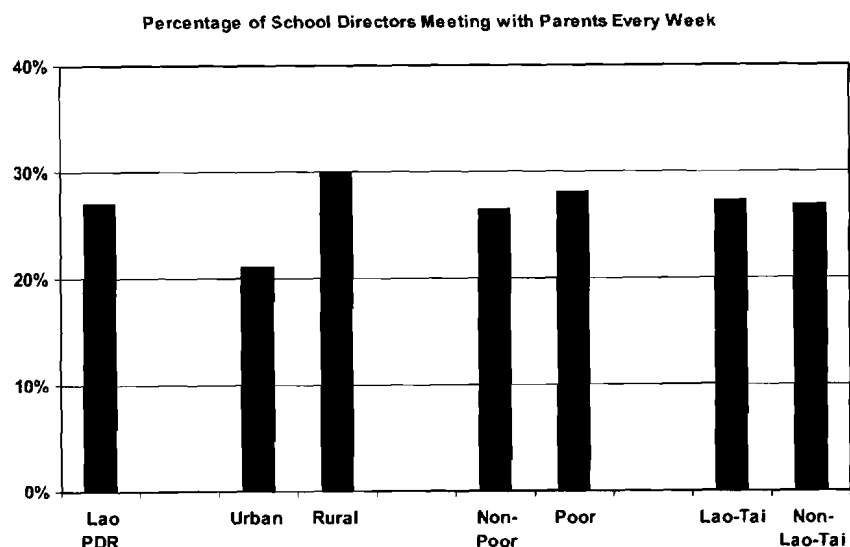
Data source: PETS.

## Accountability

**The inequitable distribution of resources for operating costs between poor and non-poor areas is an important concern.** But a certain degree of financial dependence on communities and parents may help holding schools directly accountable to parents. There may be a tradeoff between the need for greater central authority to capture society-wide benefits, such as social cohesion, and the need for greater local influence because student learning is difficult to monitor at the central level. Some argue that as long as locally collected fees are retained by the school, fees are a good thing. While centrally controlled resources are exclusively devoted to payroll, resources collected at the school level can increase the total amount of resources available to schools.<sup>7</sup> Also, by financially contributing to schools (in monetary terms or in kind), parents can have a better say in affecting the resource utilization to help tailor the service to their needs. They can also be effective monitors of providers, since they are at the point of service delivery. The survey shows that one out of four school directors meet with parents every week; while only one out of seven school directors meet with officials from DEB this often (Figure 41).

<sup>7</sup> Such accountability is crucial. For many parents there is no choice of schools, hence no “voting with your feet.” For families in rural areas, there is usually just one school in the neighborhood.

Figure 41: More school directors meet with parents on a weekly basis than with officials from DEB.



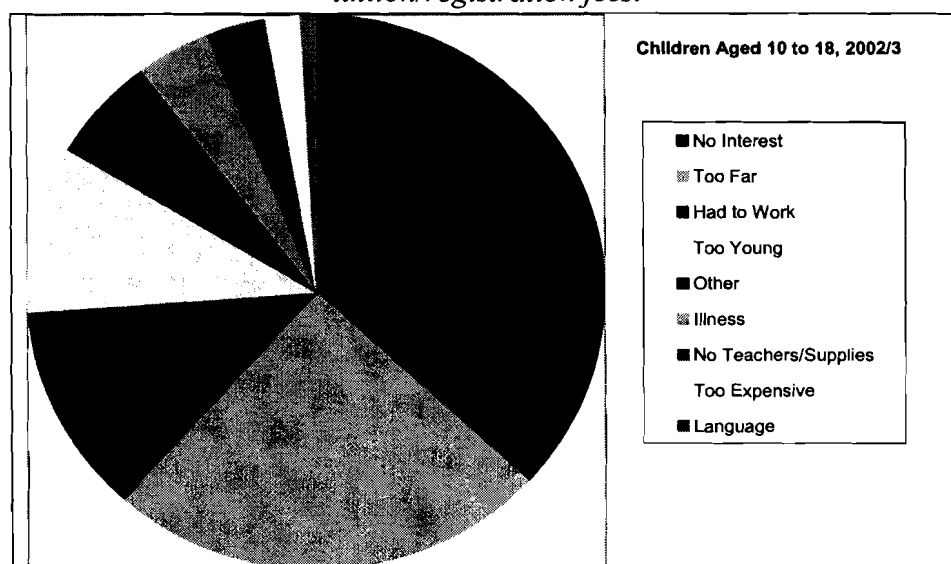
Data source: PETS.

Free primary education rests on social, equity and efficiency considerations; the negative impact of a tuition/registration fee on enrollment may be limited. First, tuition fees are a small part of household expenditures on education. According to the 2002/03 LECS, tuition and other fees account only four percent of household education expenditures in rural areas, and about nine percent in urban areas (King and van de Walle, 2005). The bulk of private expenditures on education go towards uniforms (45 percent), textbooks and materials (20 percent), transportation (15 percent), and other items. Second, about two out of three schools exempt pupils from tuition fees when they are unable to pay, and others request inputs in-kind. Only three percent of the schools



dismiss student in case they cannot afford tuition fees. Third, more children fail to enroll in school for different reasons than direct expenses (Figure 42). Among children aged 10 to 18 years who have never attended school, the direct cost of schooling (rather than the opportunity cost such as lost income from work) is preventing no more than two percent to go to school. Instead, nearly two out of five are not interested in school<sup>8</sup>; over one out of four consider the schools as too far away; one out of seven have to work instead; and less than one out of ten claim to be too young. Hurdles for school enrollment vary across areas. In urban areas, less than one out of ten is not enrolling due to the distance to school, while it is almost three out of ten in rural areas. Among the urban poor, almost three out of ten never attended school reported that they have to work, compared to about one out of seven among the rural poor.

*Figure 42: More children are kept out of school for reasons other than tuition/registration fees.*



Data source: PETS.

## Conclusions

**To achieve education MDGs and the objectives of the NSEDP education policy, it is important for the Lao government to devote more resources to education.** It is also critical to more efficiently allocate public funding to primary education and to target less well-off areas. Although teachers have high job morale and low absenteeism, the low level and delays of teachers' salaries, insufficiency of operation funding, lack of schools with basic facilities, shortage of teaching materials and textbooks, and inadequacy of professional training for teachers combined negatively affects the quality of primary education. Inequitable distribution of resources between well-off areas and less well-off areas, mismatch of capital spending and recurrent spending, and shift of public education expenditure from primary to secondary further lower the effectiveness of the limited

<sup>8</sup> However, reasons behind are to be examined.

public spending. Compared to teachers in well-off areas, teachers in less well-off areas face more frequent salary delays, work in schools with poorer infrastructure and smaller operational budgets, have fewer teaching materials available, have larger class sizes, and receive less training especially for multi-grade teaching. Improving resource availability and timeliness and lowering transaction costs are important for reducing delays in teachers' salary payment and enhancing education service delivery.

**There is little evidence to suggest that salary leakages from the district to school, absenteeism or ghost teachers are a major concern in Lao PDR.** To better deliver service to poor people, it is important to increase education spending to bolster teachers' salaries and to better cover operating costs, streamline budget planning and execution process, strengthen reporting system and capacity, and improve the accountability of schools and policymakers to parents/citizens.

## HEALTH

*Health defines the ability to work, feed and sustain a family, to save for the future, to grow and develop, and to lead a fulfilling life. A healthy population translates into greater national wealth by improving the ability of children to learn, of families to plan their lives, and of workers to be productive.*

*Key health outcomes improved in Lao PDR over the past decade, even though in absolute terms, they are still low. Life expectancy got better, infant and child mortality did too. Health workers are satisfied with their jobs and housing conditions. Their rate of absenteeism is low and they are willing to contribute to community development. NGOs and local community actively support frontline services. Leakage of health workers' salaries from the district level to healthcare centers is also low. However, to achieve the level of health identified by the MDGs and the NGPES, more progress is needed. For example, there is still significant room for improvement on childhood immunizations and maternal health and for health outcomes in general. Spending on health is low and the allocation of public resources is inequitable. Public expenditures tilt towards the center, which means poor people have less access to care. There is a mismatch between capital spending and recurrent spending, which reduces efficiency even further. Unrealistically high revenue forecasts and shortfalls in public funding translate into budget cutbacks. These cutbacks tend to perpetuate themselves and weaken the management of expenditures.*

*Several factors constrain service delivery at the facility level; low salaries and frequent delays in the payment of health workers' salaries are two glaring examples. Healthcare centers are also poorly equipped; they rely heavily on local support and Revolving Drug Funds. Poor people also suffer from limited access to healthcare services of acceptable quality.*

*This chapter: (1) reviews the changes in health outcomes; (2) examines the level and allocation of public health funding and analyzes the weaknesses in public expenditure management; (3) presents a snapshot of health service delivery at the frontline, examines the sources of funds, and analyzes key constraints; and (4) conclusions.*

### Outcomes

**Key health outcomes have been improving over the last decade for Lao PDR's population.** The most important achievements are the reductions in infant and child

mortality rates. Infant mortality rate, defined as the number of newborn children who die during the first year of their life, decreased from 104 per 1000 live births in 1995 to 70 per 1000 live births in 2005. The under-five mortality rate, defined as the number of children who die between birth and the age of five, dropped from 170 per 1000 live births in 1995 to 98 per 1000 live births in 2005. The fall in mortality rates helped to lift average life expectancy from 50 years in 1990 to 55 years in 2003. According to the 2005 Population Census, life expectancy increased from 52 years for women and 50 years for men in 1995 to 63 years for women and 59 years for men in 2005.

**Progress in lowering mortality rates is remarkable, but important challenges remain.** While life expectancy has increased, Lao PDR's average life expectancy of 61 years is low compared to about 70 years in neighboring countries, such as China, the Philippines, Thailand and Vietnam. The proportion of children immunized against measles and the share of births assisted by skilled personnel are still low.

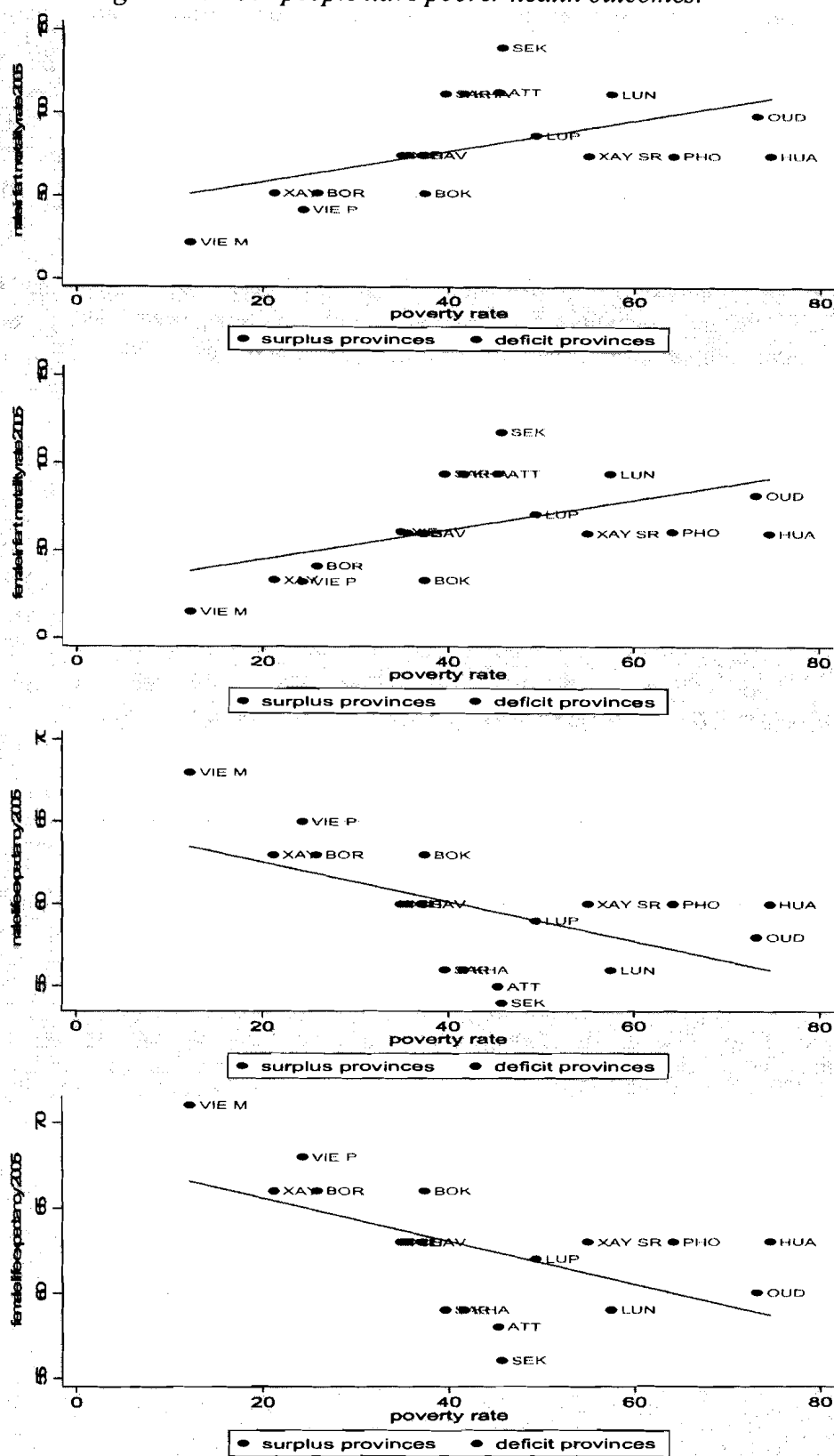
**Poor health outcomes result from many factors, such as inadequate access to health care, poor nutrition practices, and careless handling of water and waste; unfortunately, health outcomes are worse for poor people (Box 5).** Infant mortality rates are higher and life expectancy is lower in provinces with higher poverty rates. For example, in 2002/03, Vientiane Municipality is the province with the lowest poverty headcount, lowest infant mortality rate, and highest life expectancy (Figure 43). Sekong has a poverty headcount more than 150 percent in excess of Vientiane Municipality, and it has the highest infant mortality rate and lowest life expectancy.

#### *Box 5: Why Poor People Have Poor Health*

Poor people in most countries have the worst health outcomes. They are in poor health because they are poor; and they are pushed further into poverty due to ill health. Unlike education, health outcomes are produced by households—with contributions from many services. Inadequate care for illness, lack of access to good health care services, poor nutrition practices and careless handling of water and waste are major contributors to poor health. Illiteracy, women's ignorance of health issues, and lack of decision-making are often the causes. Moreover, the difference in reactions to the same level of health input between the poor and the non-poor on health outcomes is large. Studies suggest that poor people are less efficient than rich people in translating inputs, such as drinking water, sanitation, and health services, into better health outcomes. While the availability of inputs is already different, the low ability to transform those inputs into health further results in poor health outcomes of poor people. The gap in health outcomes between poor people and rich people have been widening over time.

*Source: World Bank (2003).*

Figure 43: Poor people have poorer health outcomes.



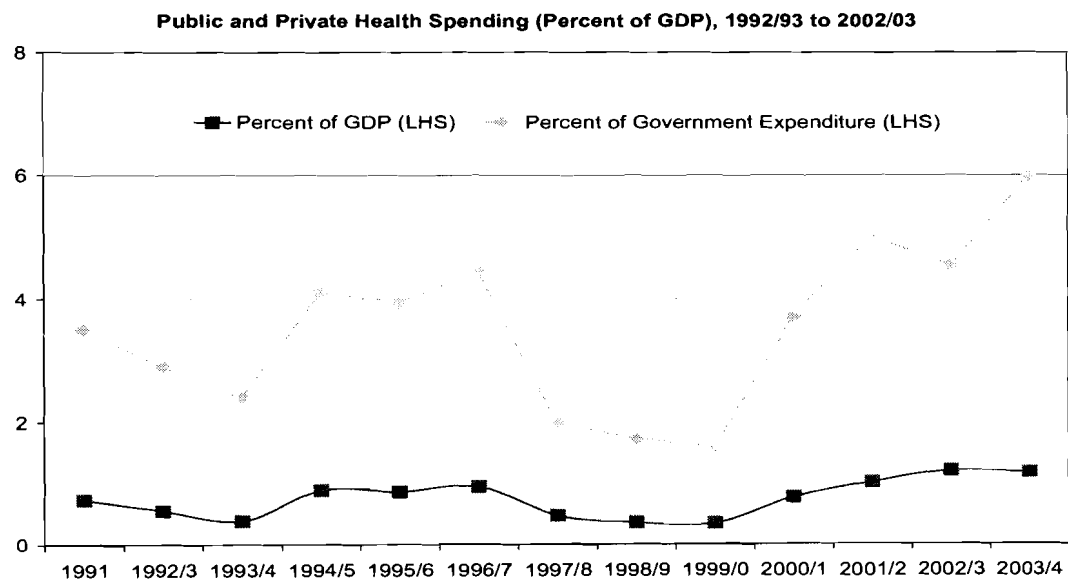
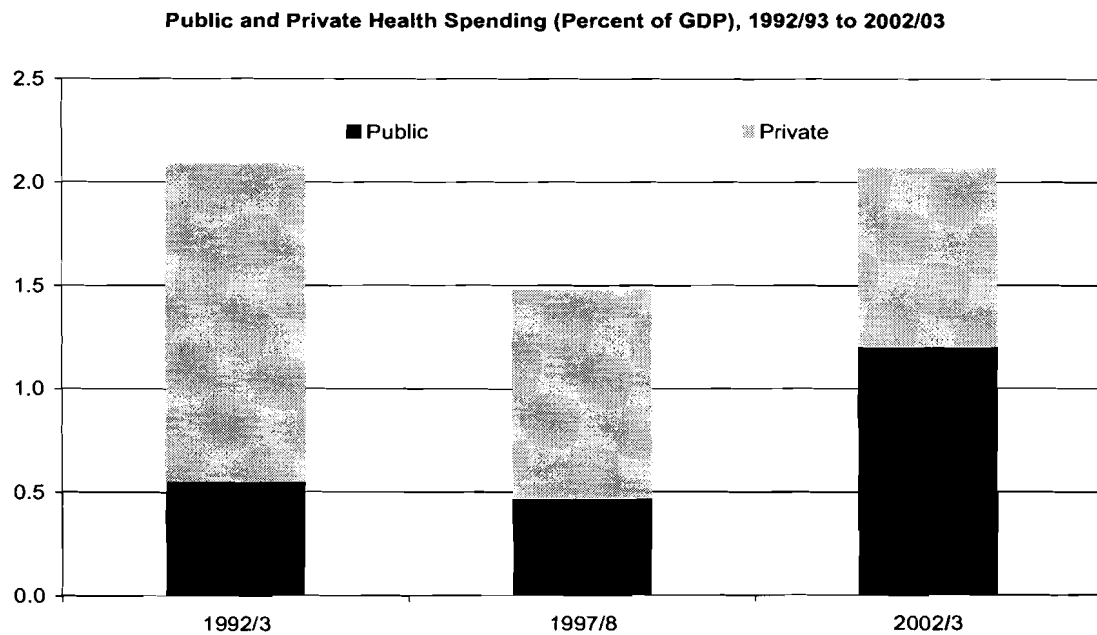
Data source: Lao Population Census 2005.

## Public Funding

**Public and private spending on health is low in Lao PDR.** Although the sum of public and private per capita health expenditures increased by about one-third since the late 1990s, it was just 8.7 USD per capita in 2002, which was equivalent to over 2 percent of GDP (World Bank, 2006b). Compared with other low income countries with an average of 29 USD health expenditure per capita, 8.7 USD keeps Lao PDR in the very low end of the spectrum. If compared with the East Asia average, 64 USD, the gap is even larger. The low level of spending is closely associated with the poor health outcomes in Lao PDR.

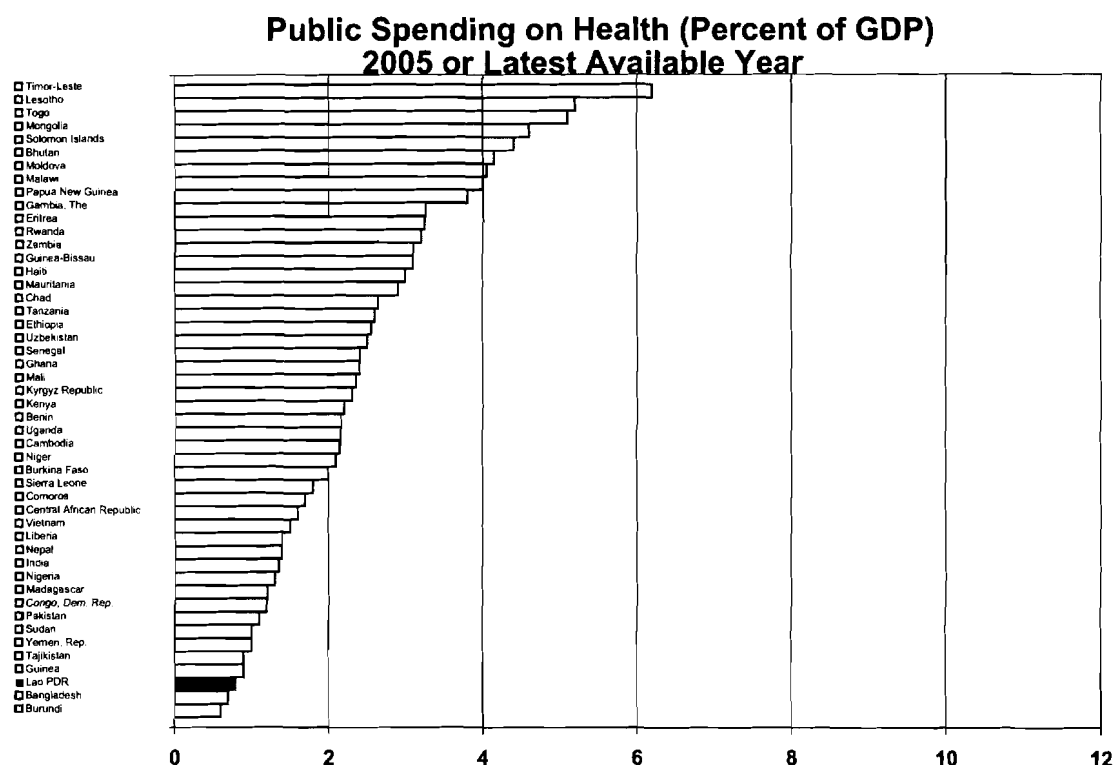
**The proportion of public health expenditures as a share of total health expenditures is low; an increase in health expenditures over the last few years was due mainly to an increase in private health expenditures.** Public health spending as a share of overall government spending averaged over 4 percent in the mid-1990s, collapsed to below 2 percent towards the end of the 1990s, and increased steadily since then to reach 6 percent in 2003/04, reflecting a renewed emphasis on social sectors (Figure 44). Correspondingly, public health spending as a percent of GDP tripled from about 0.4 percent in 1997/98 to 1.2 percent in 2002/03. While these are encouraging trends, the most salient feature of the public health finance remains the scarcity of resources. Compared with other low income countries, the share of public spending on health in GDP is very low in Lao PDR, which is only one-half of that of Vietnam and two-fifths of Cambodia (Figure 45).

Figure 44: Overall per capita health expenditures are increasing, but they started at a low level.



Data source: World Bank (2006b).

Figure 45: Public health expenditures as a percent of GDP in Lao PDR are low compared to other low income countries.



Data source: WDI (2005) and World Bank (2006b).

**A shortfall in public funding at the subnational level translates into cutbacks on of expenditures.** Only one PHO (PHO in Oudomxay) out of the 17 provinces surveyed reported the proposed budget was approved with no changes made in 2004/05. In the understanding of the 16 PHO whose approved budget was lower than proposed budget, 13 PHO considered the insufficiency of funds at the provincial financial office is the key reason why the approved amount was lower than the proposed amount; three PHO (Huaphanh, Savannakhet, and Xekong) considered provincial governor's discretion is the key reason. Explanation on the difference generally comes from PFO. Large difference between proposed budget and approved budget also exists at the district level. But, only three out of five DHO receive explanation on the difference from DFO. At the district level, for the 85 percent DHO surveyed with data available, 21 percent received approved budget with no change made, 64 percent received approved budget lower than proposed amount.<sup>9</sup> Overall, almost 60 percent of DHO that received approved budget lower than proposed budget received explanations; for DHO in priority districts that received approved budget lower than the amount proposed, 75 percent received explanations.

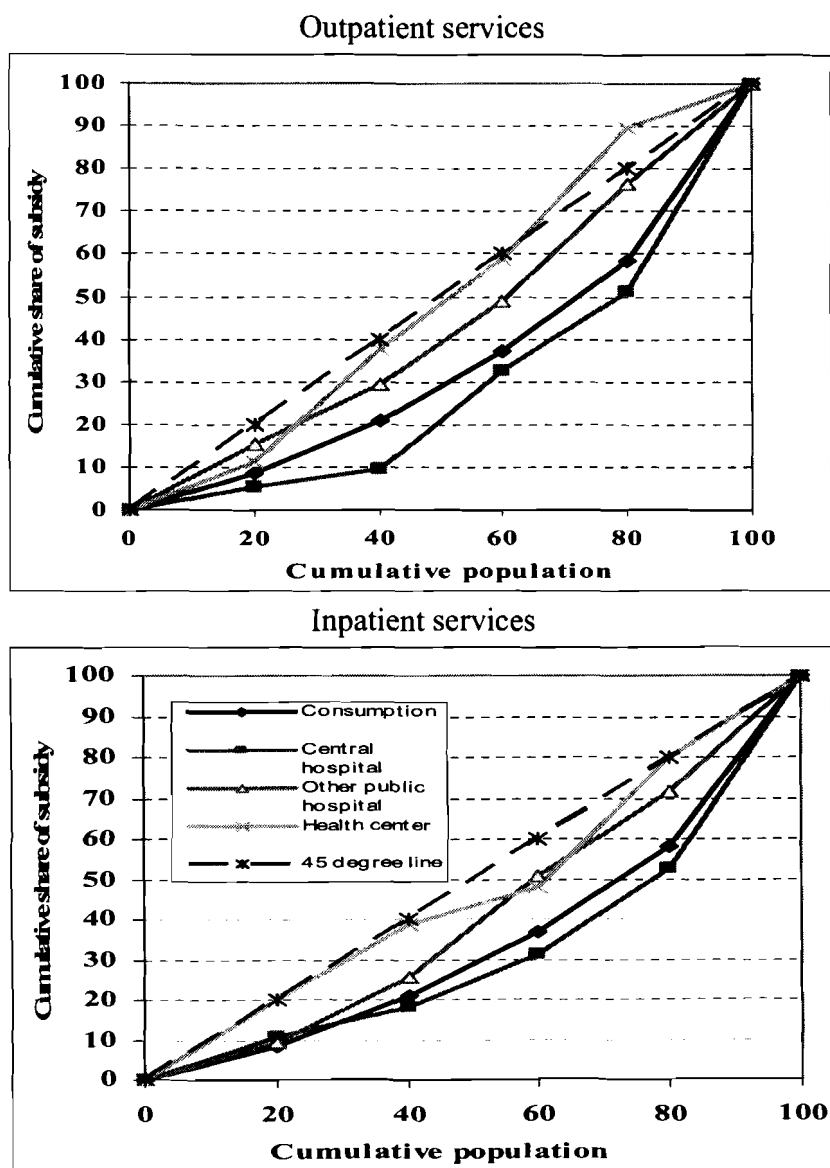
**Public health spending is not only low, but it is also allocated in an inequitable manner.** Much of government health spending is biased in favor of the central level;

<sup>9</sup> The difference in the budget acceptance rate is not significant between DHO in priority and non-priority districts.



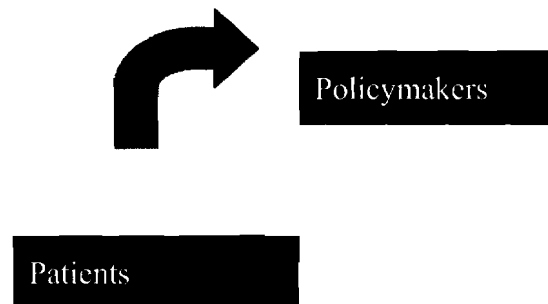
public subsidies to central hospitals are heavily biased in favor of the richest quintile. This richest group alone receives nearly one-half of total subsidies for central hospitals because the rich can better afford using health services when needed, while the poorest group gets only seven percent (Figure 46). Overall, the richest quintile captures 27 percent of public subsidies for health services compared to 13 percent of the poorest. This leaves only limited resources for frontline services: just one-fifth of public health expenditures in 2002/03 was spent in district health facilities and village health centers. These are the same facilities that should play a key role in delivering essential health services to the poor people. As in many other countries, this leads to the de facto allocation of public health spending in favor of the less poor.

*Figure 46: Concentration curves of consumption and health care subsidy by health provider and inpatient/outpatient care*



**Inferior access to healthcare services, especially to services that offer good quality, means poor people have less satisfactory outcomes.** As poor people may fail to exert their influence on public policy, governments spend a large part of health budget on “free” public hospitals used by the non-poor in urban areas, rather than population-oriented outreach services, such as immunization, that provide large benefits to the poor (Figure 47).

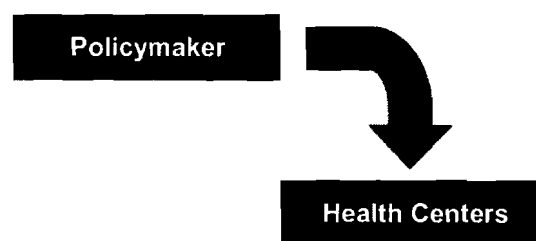
*Figure 47: Poor patients have little clout with policymakers on budget decisions.*



## **Expenditures Management**

**Management of public expenditures in the health sector is weak in Lao PDR.** Ineffective budget planning, execution, monitoring, and reporting aggravate the difficulties of insufficient funding at the subnational level; it also hinders efficient health service delivery (Figure 48).

*Figure 48: Policymakers may not be able to ensure health centers deliver efficient service.*

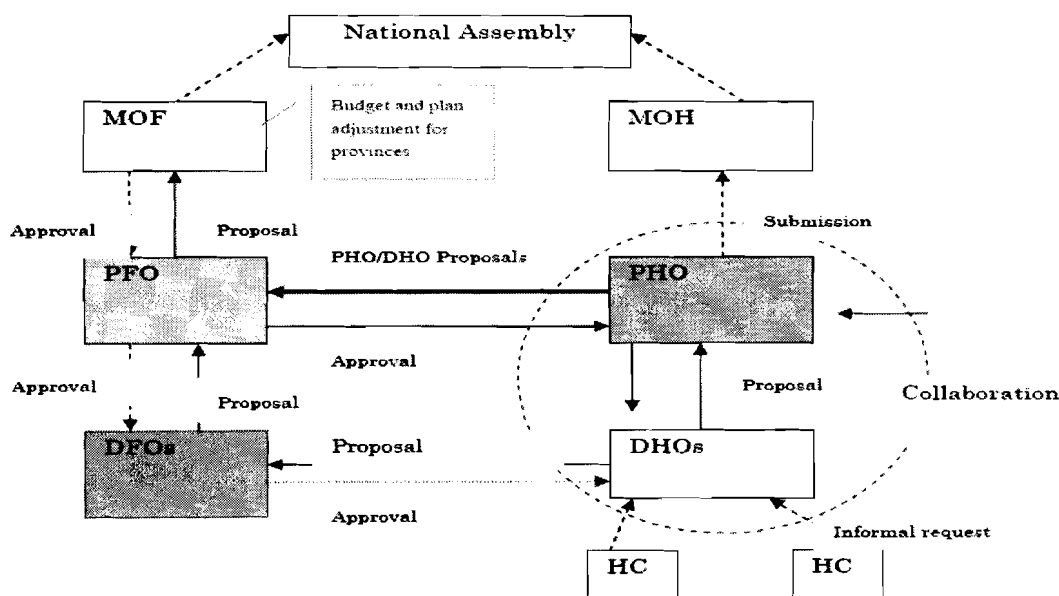


## **Budget Preparation**

**Budget preparations for the health sector are characterized by a lack of realism in revenue forecasts and fragmentation between the finance and planning functions at the central and local levels.** Budget planning receives short shrift due to a compressed budget cycle (Box 6).

### Box 6: Budget process in the Health Sector

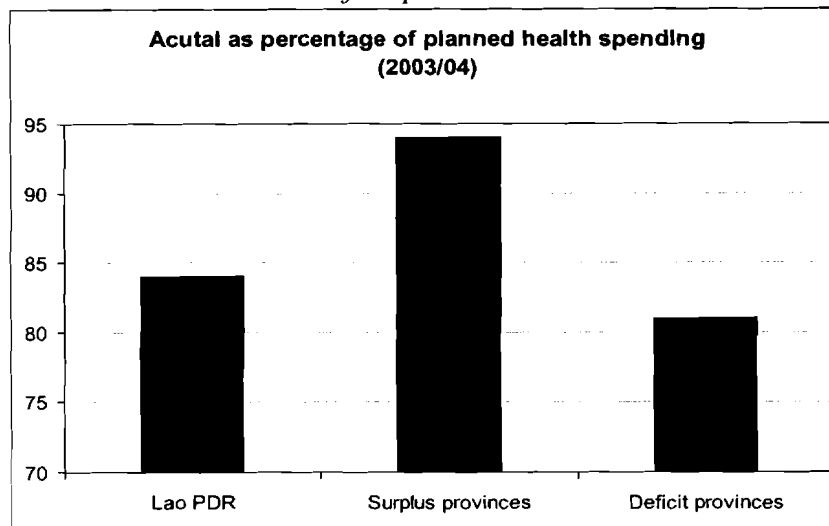
1. Budget preparation starts at the district level, as HC only make informal requests for resources but are not actively involved in formal budget proposal procedures. Most HC do not prepare or submit budget proposals to DHO or discuss annual budget with DHO. The links between HC and DHO is rather weak.
2. DHO receive guidance and instructions from PHO on budget planning and use estimates of current year funding needs, expenditure of previous fiscal year, and proposed budget of previous fiscal year as criteria to decide the total amount of annual budget proposal. However, DHO understand that the approved budget is likely to be different from what was proposed. DHO prepare annual budget plans and submit proposals to DFO for approval and to PHO for official acknowledgement.
3. PHO consolidate budgets received from DHO without adjusting the proposed budgets and submit budget proposals to PFO. PHO also submit budget proposal to the MOH, although not for approval.
4. PFO receive health budget proposals from PHO and DFO, and submit provincial budget proposals, which include health budget proposals, to MOF. When PFO get budget approvals from the MOF, they approve budgets to PHO according to what MOF accepts and approve budgets to DFO, which in turn approve budget to DHO. However, due to the large difference in approved budget and proposed budget, after receiving approval of annual budget by PFO, PHO officers submit quarterly budget proposals to request non-salary funds.



#### 1. Lack of Realism

**Budget planning in the health sector is unrealistic; it is often based on high revenue forecast.** Nine out of 10 PFO provide budget ceilings to PHO, while the ceiling is based on the unrealistic planned expenditure of PHO of last fiscal year. The budget acceptance rate is particularly low for non-salary items. No clear criteria determine whether and how much a budget proposal gets approved. According to the field interviews, the acceptance rate ranged from 13 to 29 percent for the capital costs and from 29 to 72 percent for the administration costs at the provincial level. Deficit provinces faced tighter budget constraint than surplus provinces. In 2003/04, throughout the country the actual health spending was about 84 percent of the planned spending nationwide; 94 percent in surplus provinces; and 81 percent in deficit provinces (Figure 49).

*Figure 49: Actual health spending compared to planned health spending is lower in deficit provinces.*



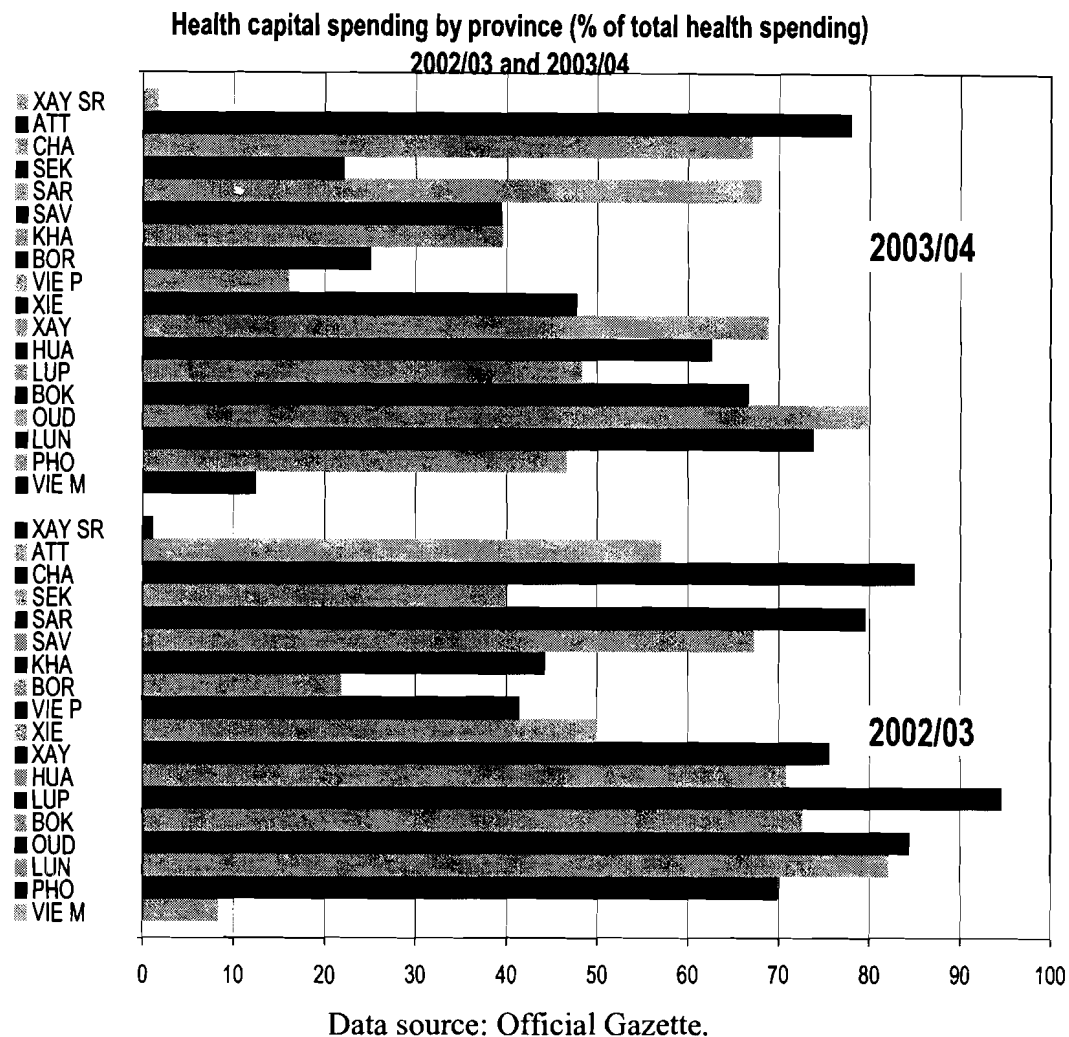
Data source: Official Gazette.

**Unrealistic proposals perpetuate themselves in budget planning.** Provinces and districts have no incentives in making exact budget proposals but they do try to maximize the non-salary budget. Many staff working in health system take low budget acceptance rates for granted as it is a yearly event and do not make efforts to actively seek explanations. The role that budget planning plays is actually weak. DHO and PHO have to readjust budget and resubmit quarterly budget proposals for non-salary expenditures even after their budgets got approved. Such budget re-submissions and re-approvals usually take a few weeks with a few steps, which waste extra staff-time, increase logistic costs, and generate delays in decision making and payment.

## *2. Fragmentation*

**Expenditure management in the health sector is fragmented at the central and sub-national levels; mismatch of capital investment and recurrent expenditures is a serious problem.** Due to the lack of coordination between capital and recurrent spending, and the lack of resources for matching funds from donor contributions, capital investment represents a high share of total health expenditures in Lao PDR. For example, the number of Lao PDR's hospital beds compares favorably with that of richer countries, but its health workers do not receive their already very modest level of salaries on time. The share of capital investment in total public health expenditures was 79 percent in 2002/03, and 56 percent in 2003/04. The share of capital expenditures out of total health expenditures varies dramatically across provinces and from one year to another (Figure 50). In 2002/03, Vientiane Municipality spent 8 percent of total health expenditures on capital investments; in 2003/04, the share increased to 12 percent. By comparison, in 2002/03, Luangprabang province spent 95 percent; in 2003/04, the share dropped to 48 percent. The changes reflect partly the lumpiness of capital investment, but also adjustment how donors allocate funds to provinces.

Figure 50: Health capital spending varies across provinces and by year.



The amount of resources allocated to recurrent health expenditures are low and volatile as a disproportionately large share of the already limited amount of public resources has been devoted to capital spending. Overall, in 2002/03, 29 percent of recurrent health care expenditures went to non-wage expenditures; in 2003/04, it was 22 percent. The share varies widely across provinces (Figure 51). For example, Phongsaly province spent about 10 percent of recurrent expenditures on non-wage costs; some provinces, such as Luangnamtha, Xayabury, Vientiane and Attapeu spent more than 35 percent in 2002/03. Within each province, the variation from one year to the next is relatively small as wage allocations remains fairly constant. In per capita terms, public health recurrent expenditures also vary dramatically across provinces (Figure 52). For example, in 2003/04, per capita health recurrent expenditures in Sekong province were more than three times that of Vientiane Municipality. However, per capita recurrent health expenditures show no systematic correlation to income, poverty, or health outcomes.

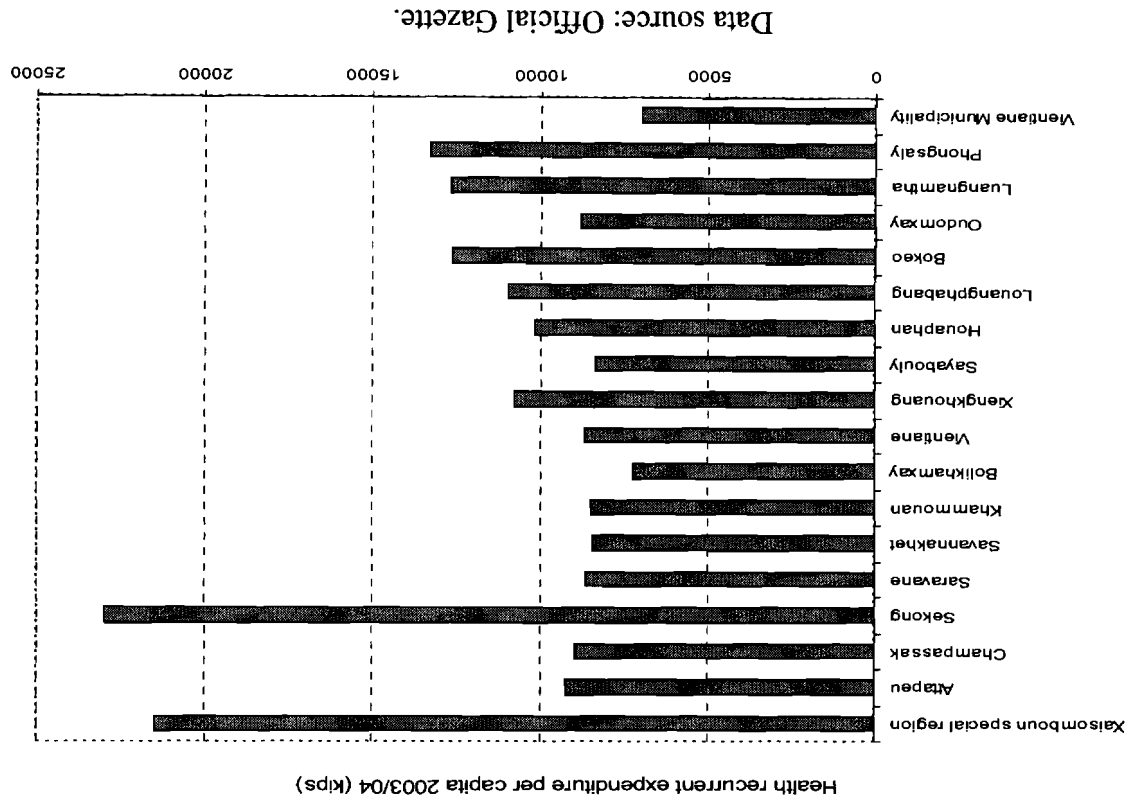


Figure 52: Health recurrent expenditures per capita vary across provinces.

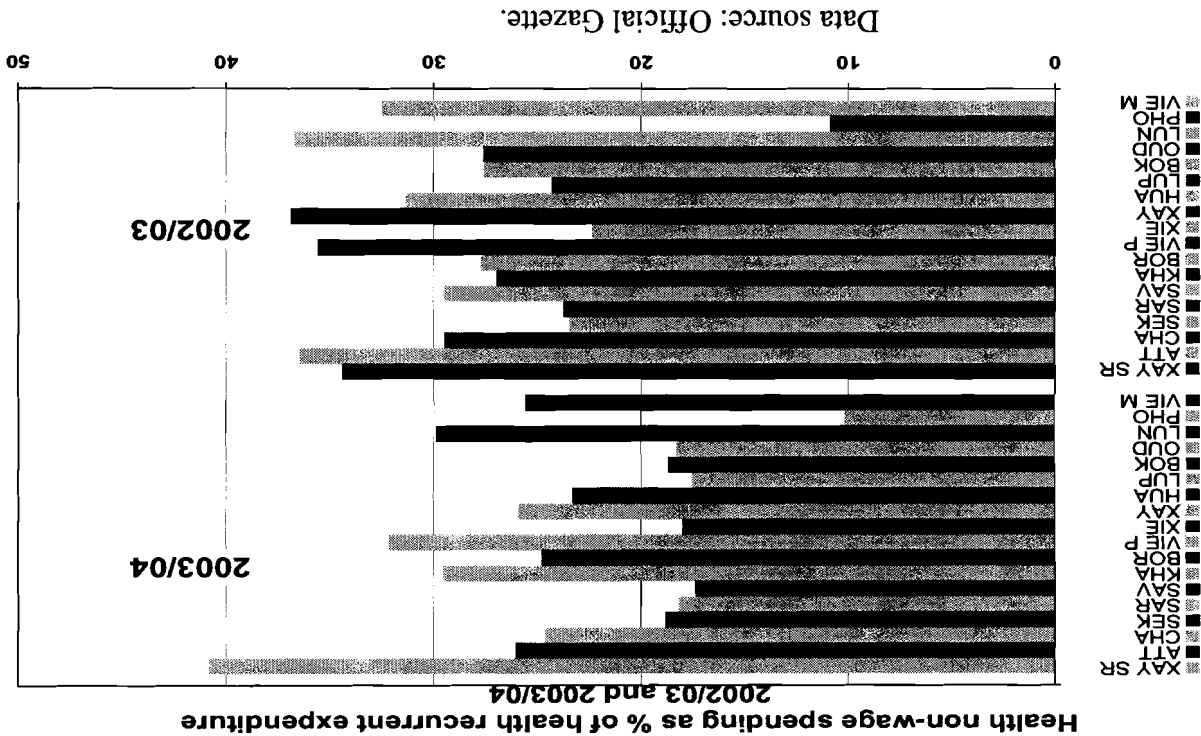


Figure 51: Health non-wage spending varies across provinces.

### *3. Compressed Budget Cycle*

**The tight budget preparation schedule, which runs from May to September, leaves little time for input from districts or health centers.** Coordination between the center and provinces is poor; budget preparation cycle is always late. MOF is the institution that determines overall budget allocation among provinces and across sectors, and redistributing resources from surplus PFO to deficit PFO, but MOF does not control how PFO further distribute the payments across sectors and/or to different DFO. Provincial governor makes decision in allocating resources to sectors within the envelope, and the MOH is only acknowledged in the process. Criteria for determining whether a budget proposal gets approved are not transparent. At the provincial level, PFO provide in most cases an explanation when PHO budget submissions get revised. But only three out of five DHO received in 2004/05 an explanation from DFO.

### **Execution and Reporting**

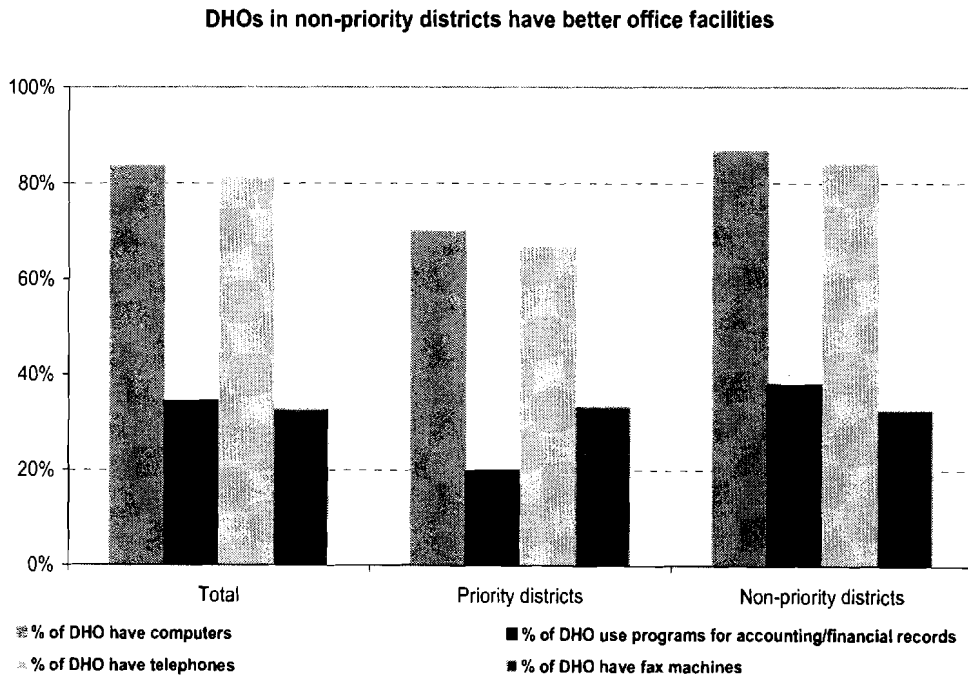
**Budget execution is weak for the health sector.** An unclear division of responsibility by ministries leads to delays in executing the budget. In average, it takes about a month for DFO to approve payment requests from DHO; in priority districts, it takes up to six weeks. When making purchases, the DHO has first to request a purchase authorization for the proposed item from DFO; then DHO gives the authorization number to the retailer after it is issued by DFO. Finally, the retailer requests payment from the DFO by providing the authorization number. Fourteen out of 17 PHO have a dedicated bank account for money transferred from the PFO to PHO. Eight PHO also have cash accounts for government funds. However, only one out of two DHO have bank accounts; and only one out of four have a dedicated bank account for money transferred from DFO. Few DHO have cash accounts for governmental funds. The long and cumbersome authorization and processing procedures and the unclear division of responsibilities between MOF and MOH and their officers at the subnational level lead to delays and inflated procurement costs.

**A reporting and monitoring system exists for subnational governments and line ministries, but their respective responsibilities are unclear and institutional mechanisms are weak.** Reporting system mainly starts at the district level as reporting from HC is generally missing. DHO report the total number of health workers at the district level to the District Personnel Department quarterly, and make a request in written with defined format for salary payment approval. PHO closely supervise DHO, for example, PHO visits DHO for supervision every month; DHO staffs also have monthly visits to PHO for official reasons. PHO provide trainings to health workers of DHO and HC. HC receive supervisions from DHO every three months, and supervisions from PHO twice a year. In two out of three cases, HC health workers are formally assessed by HC director or DHO a few times a year. Due to the variety of reporting standards, it is difficult to monitor health expenditures and to evaluate whether or not national priorities are being followed. Basic systems for report keeping and accounting are in place. Vertical reporting and supervision varies little across the provinces and districts. The reporting system usually starts at the district level, as there is little reporting

from health centers. PHO have standardized and well-documented financial records, including computerized accounting books, money execution authorization forms, and receipts. PHO have separate accounting books for governmental and project budgets as well as drug funds. However, DHO lack the resources and capacity to maintain spending records in the same detail formally provided by PHO. As a result, functional data for the health sector is not provided to MOH or MOF. Health centers get supervised by DHO every three months and by PHO twice a year; but do little reporting.

**Health departments at the district level, especially DHO in priority districts, are not adequately equipped to carry out their execution and reporting functions.** For example, only one out of three DHO has fax machines. Relatively speaking, DHO in non-priority districts have better office facilities than DHO in priority districts (Figure 53). Almost 90 percent of DHO in non-priority districts have computers compared to 70 percent of DHO in priority districts. Almost 40 percent of DHO in non-priority districts use accounting programs compared to 20 percent of DHO in priority districts. About 85 percent of DHO in non-priority districts have telephones compared to 67 percent of DHO in priority districts. Compared with DHO, PHO are better equipped—each PHO has computers, telephones, and fax machines, use accounting programs; 14 out of 17 PHO surveyed have copy machines.

*Figure 53: DHO in non-priority districts have better office facilities.*



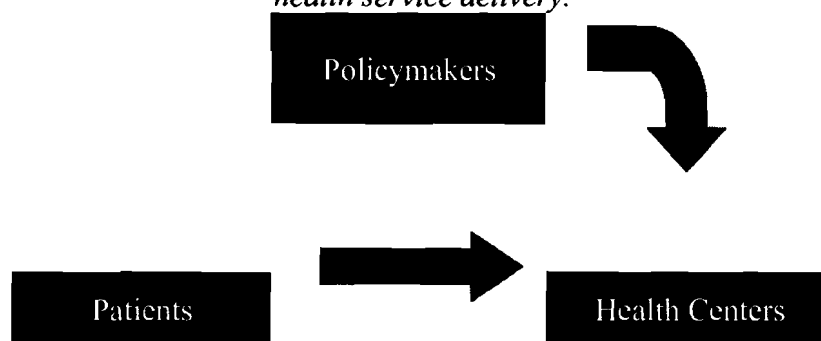
Data source: PETS.



## Frontline Services

**Efficient functioning of health centers at the frontline is important for service delivery.** As the entire health sector has inadequate resources, HC to which poor people can access are more likely to face severe constraints. This section elaborates on how communities/NGOs can complement the long route of accountability of healthcare centers vis-à-vis policymakers through direct accountability towards patients (Figure 54). From the prospective of Health Centers, this section focuses on health workers' salaries, operation costs, Revolving Drug Funds (RDF), HC access and quality, and accountability.

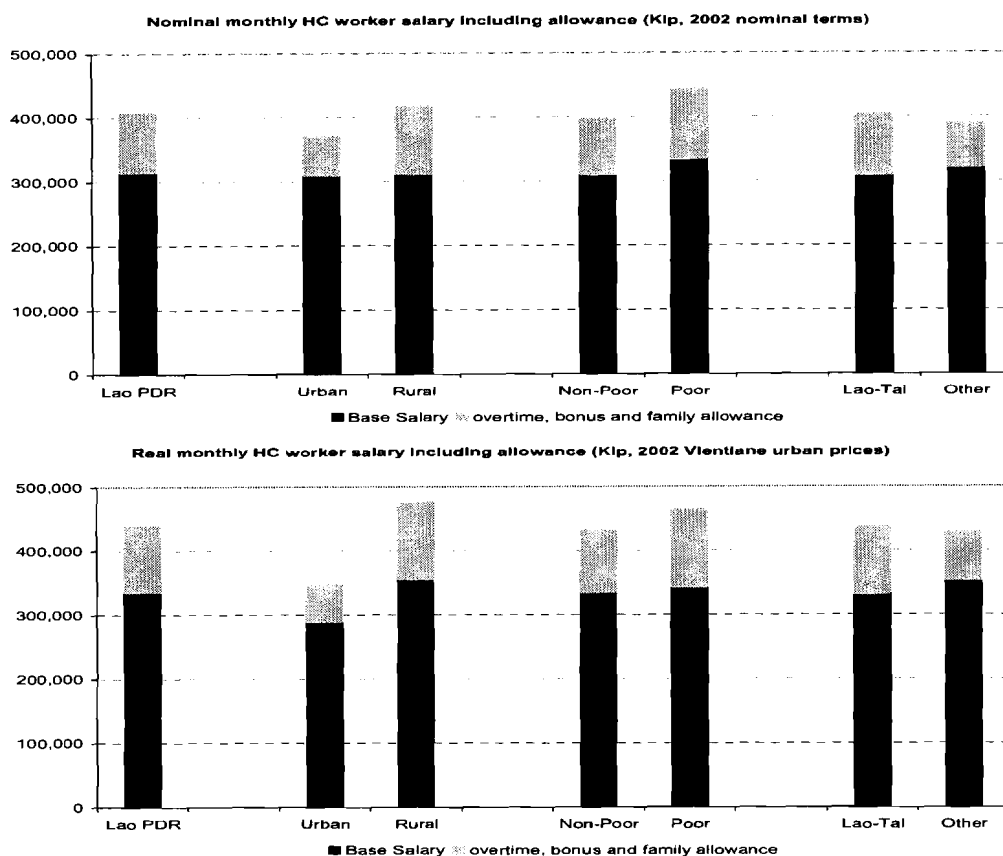
*Figure 54: Accountability of Health Centers to policymakers and patients is crucial for health service delivery.*



## Health workers

**In Lao PDR health workers' salaries are low.** The average level of health workers' overall monthly salary is about Kip 450,000, or USD 45, including base salary, overtime, bonus, and family allowance. On average, about Kip 350,000 is for base salary; and about Kip 100,000 is for overtime, bonus and allowance. The total salary of health workers is about 150 percent of the GDP per capita of Lao PDR, which is low by international standards. In Lao PDR, more than nine out of 10 health workers surveyed reported their salaries were too low to cover the cost of a minimum standard of living. In nominal terms, health workers' base salary varies little for workers in poor areas and non-poor areas, those in rural and urban communities, Lao-Tai concentrated areas and elsewhere (Figure 55). However, health workers in poor areas and rural areas have higher benefits and family allowance payments. In real terms, as living expenses are lower in less well-off areas, the salaries of health workers there have higher purchasing power than those in well-off areas.

*Figure 55: HC workers' salaries vary little in nominal terms; they are higher in rural areas in real terms.*



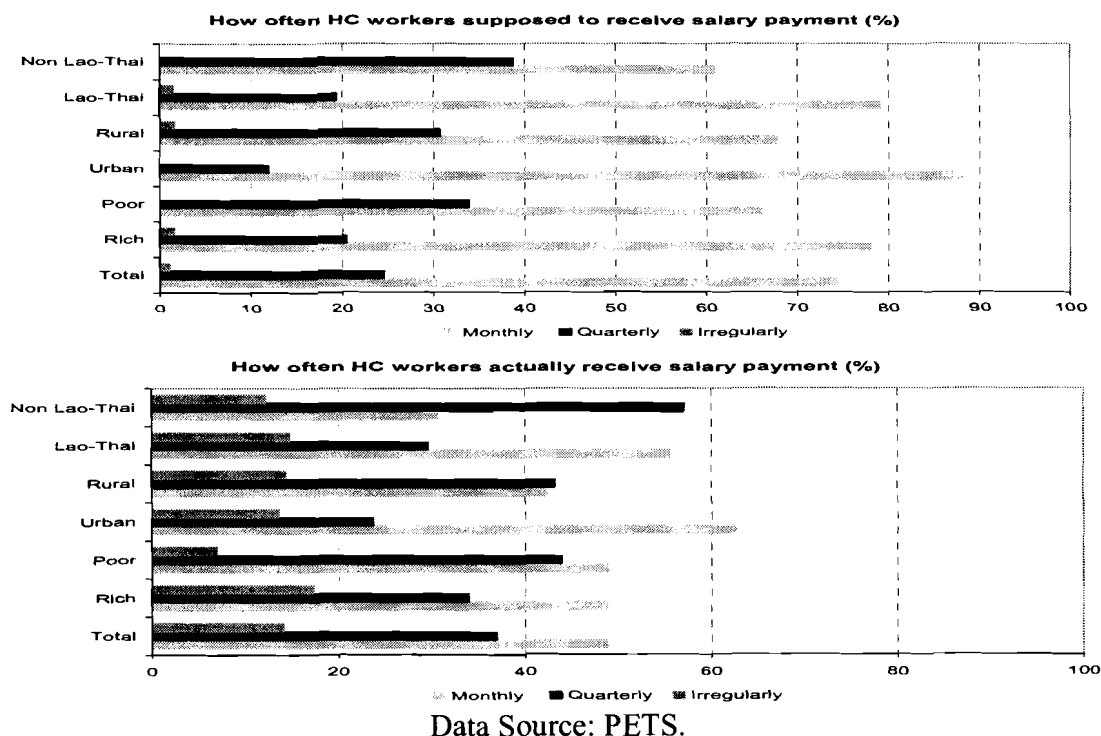
Data source: PETS.

**Delays in payment of salaries are frequent for health workers, especially those in less well-off areas.** The data from Ministry of Health suggests in the last quarter of FY05 and the first quarter of FY06 GOL has paid out the salaries of health workers such that the stock of salaries outstanding more than 1 month came below 22 percent of a month's payroll; and that severe arrears in salaries (over three months) have essentially been eliminated at less than one percent of a month's payroll (World Bank, 2007a). However, PETS results indicate a less favorable picture.<sup>10</sup> According to the survey, two out of three HC workers experienced delays in payment of salary or benefits between October 2004 and September 2005. Although health workers in rural areas have higher total salary in real terms than those in urban areas, they are almost 10 percent more likely to experience payment delays. In addition, health workers receive their salary less frequently than they are supposed to. Three out of four health workers in health centers reported they should receive their salary every month (Figure 56). However, in practice, only one in two health workers receive their salaries every month; 37 percent receive payment every three months; and about 14 percent are paid irregularly. Monthly payment schedules are more common in urban, non-poor and Lao-Tai areas. Health workers in poor, rural, and non

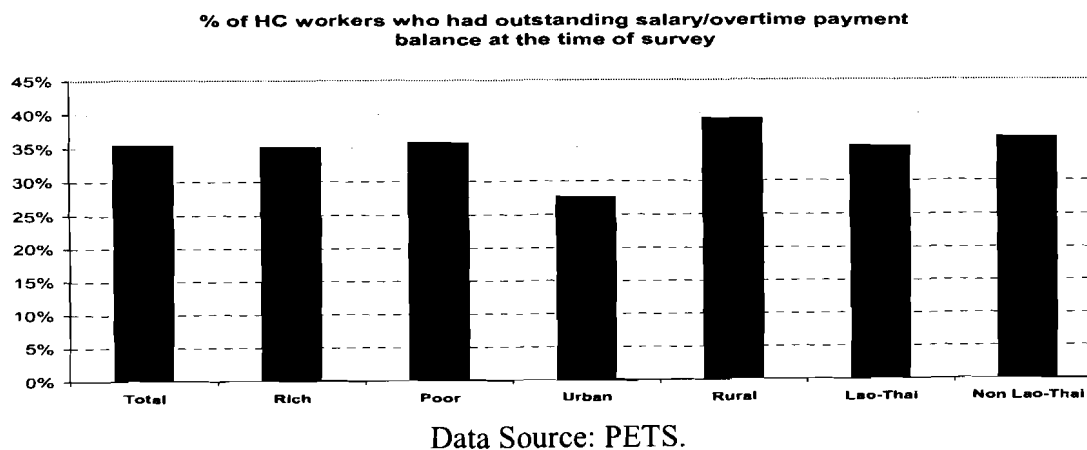
<sup>10</sup> The numbers are not directly comparable. Discrepancies in salary payment between different sources of information can come from, for example, sampling and timing.

Lao-Tai areas received payment less frequently than those in non-poor, urban, and Lao-Tai areas. At the time of the survey, one out of three health workers had an outstanding balance of salary or overtime, bonus or allowance (Figure 57). Even in urban areas, one out of four health workers was owed salaries.

*Figure 56: Health workers in health centers get paid less frequently than they are supposed to.*



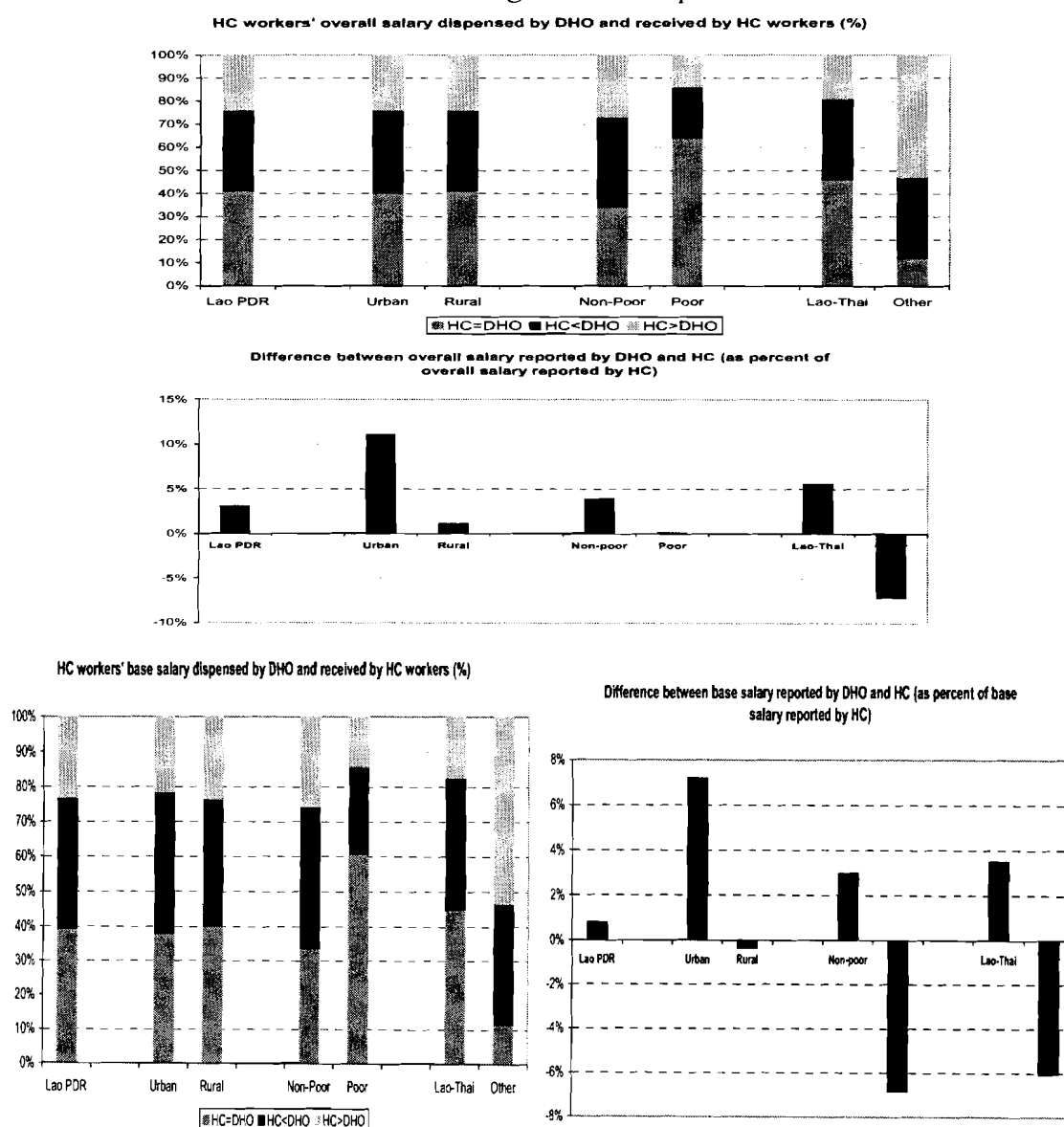
*Figure 57: One out of three health workers had outstanding balances due for their salaries and overtime at the time of the survey.*



There is little evidence to suggest that salary leakage between district and health centers is a key concern in Lao PDR. Based on the salary payment records of the 267 health workers surveyed in PETS, the discrepancy in reported salary between DHO and HC is small: amounts only to about 3 percent of total salaries and 1 percent of base

salaries (Figure 58). Deviation takes place in both positive and negative directions. DHO and health centers report payments coincide for about two out of five cases for total salaries. DHO reports higher payments than the health centers for about one out of three cases; and DHO reports lower payments than health centers for about one in four cases. The numbers are similar with regard to base salary. Discrepancies are greater in urban area, non-poor, and Lao-Tai areas, but the average magnitude remains low in both directions. In poor non-Lao-Tai areas, salaries received by health centers often exceed salaries released by the DHO, which coincides with the anecdote observations that facilities obtain support from communities and donors to supplement health workers' salaries.

*Figure 58: Overall difference in salary payments reported by DHO and HC is small, but some areas have greater discrepancies.*

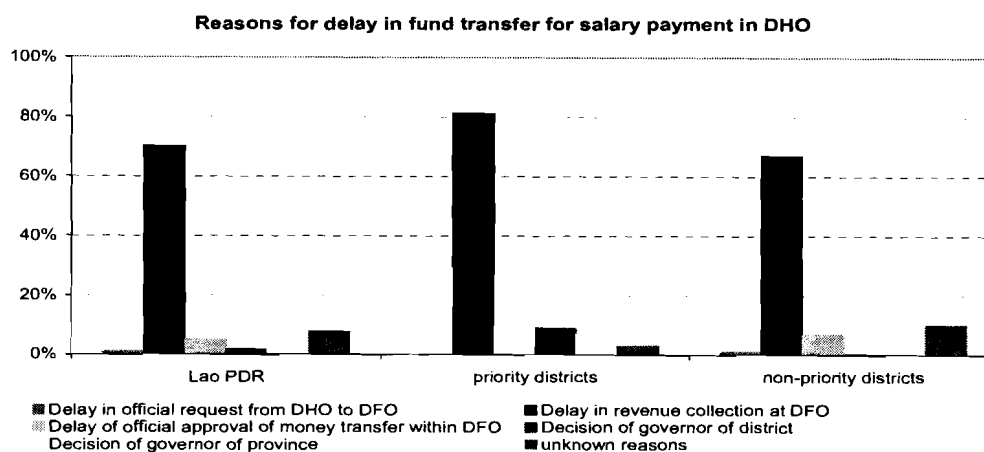


Data Source: PETS.

**There are good reasons why ghost health workers are not a concern.** Health workers need to sign when receiving their payments, as all salaries are paid in cash. DHO keep salary records for each health worker. DHO report quarterly the total number of health workers at the district level, and make a written request, based on a prescribed format, for salary payment approval. PHO closely supervise DHO every month; and DHO staffs also have official monthly visits to PHO.

**Insufficient funds are apt to be a key contributor to salary delays in the health sector.** Health workers surveyed have little doubt about the cause of payment delays. All of them stated that insufficient funds are the main reason. Two out of three DHO considered weak revenue collection from DFO to be the reason for delay in fund transfer for salary payment (Figure 59). Indeed, when DHO receive the salary funding from DFO, it takes only a few days for DHO to pay in cash to health workers at the district level. As in the education sector, high transaction costs contribute to the delays in salary payment,

*Figure 59: Delays in revenue collection at DFO are the primary reason for salaries being in arrears.*

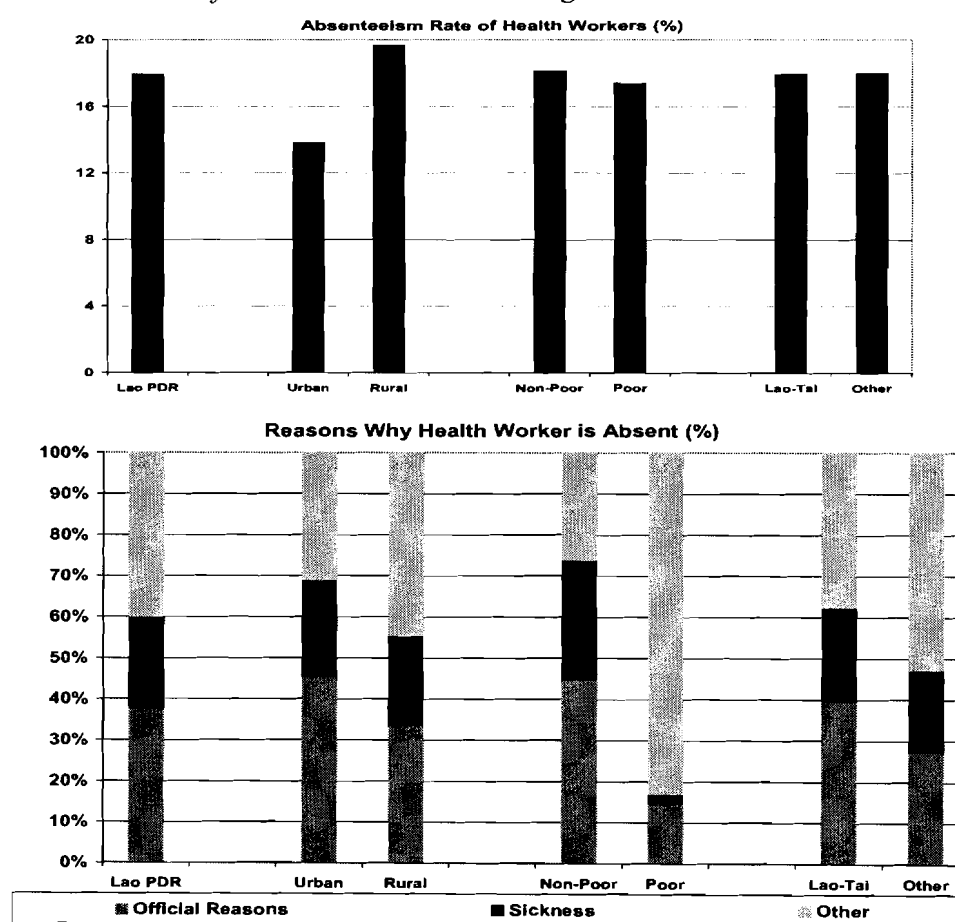


Data source: PETS.

**Despite low salaries and frequent delays in payment, most health workers have high job morale and are seldom absent from work.** Three out of five of the health workers are natives to the area where the health center is located, and most understand the language of the community. Most health workers in health centers surveyed reported they are satisfied with their job and housing conditions. They believe that they provide satisfactory services at the HC. They are satisfied with the staffing at HC and with the availability of drugs. They are very satisfied with the overall work at HC, and willing to contribute to community development. A high degree of job satisfaction and job motivation in Lao PDR helps to limit job absenteeism. The absence rate for health workers is 18 percent in health centers for a PETS unannounced visit (Figure 60). In addition, only two out of five of absent health workers were absent without legitimate reasons, such as official visit or sickness. The absenteeism rate is low in international comparison. Similar survey measured absence rates of 25 percent in Peru, 35 percent in Bangladesh, 37 percent in Uganda and 40 percent in Indonesia and India.

However, low salaries and frequent delays in payment have a negative impact on health service delivery. Many health workers have to take multiple jobs, most often in agriculture, to supplement their incomes; some also have to borrow money. On average, a health worker spends 14 hours a week doing work other than their jobs at health centers. Among those who have income from a non-medical practice, the average monthly non-medical income is about 250,000 kips. Providing private health care services, selling medicines from home, or doing commercial works are, however, uncommon among health workers. Fewer than one out of two health workers consider it acceptable to receive money from patients for the health services they provide, including consultations and drugs.

Figure 60: Less than one out of five health workers are absent from work, just two out of five are absent without a legitimate reason.



Data Source: PETS.

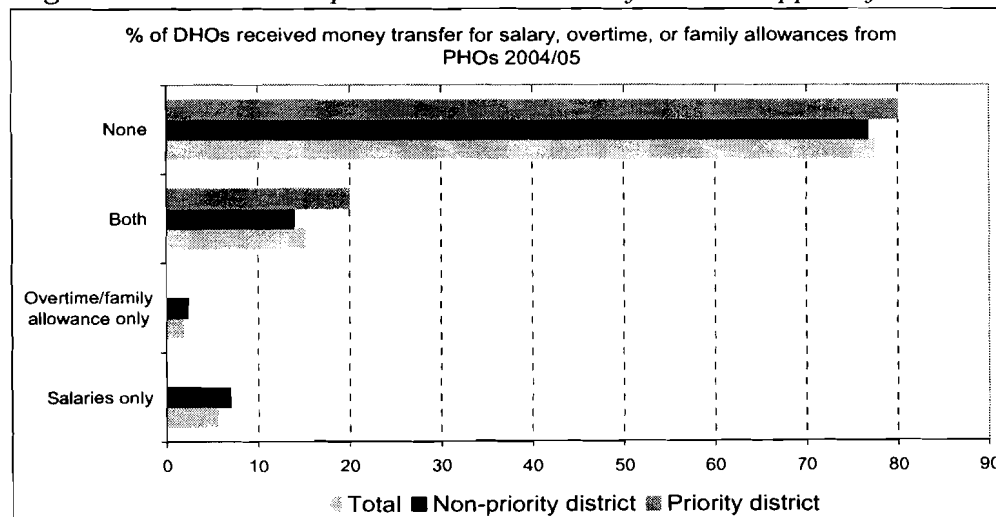
## Resource flows and Revolving Drug Funds

Resources from donors, NGOs, communities, and patients are often important sources of funds for the health sector. However, providing budget for PHO and DHO is responsibilities of provincial and district authorities. Resources from governmental budgets mainly cover salary payment, but that are in general inadequate. PHO are mostly

funded by resources from the provincial government. PHO pay the salaries of PHO staff and the provincial hospital staff. DHO rely on resources from governments, donors and NGOs as well as profits from drug sales to fund their expenditures. DHO pay the salaries of DHO staff and the district hospital staff. Health workers' salaries and overtime compensations are mainly financed by governmental budget. Resources from district authorities, resources from donors and NGOs, and profits from drug sales are main sources of funds of DHO. Although budget received from DHO is an important source, Health centers rely heavily on RDF funds and contributions from donors, NGOs, and communities to supplement operation costs. DHO may also distribute free drugs, provide free means of transportation, and give free equipments to HC. PHO, DHO, and HC located in more affluent places face less severe budget constraints.

**Vertical financial support from PHO to DHO and to HC for salary and overtime payments and for maintenance costs is limited.** Less than 20 percent DHO received money transfer for salary, overtime, or family allowance from PHO (Figure 61). A high percentage of central governmental budgets are spent on salary payment, and only a small share is spent on other items. PHO pay salaries of PHO staff and provincial hospital staff. DHO pay salaries of DHO staff, district hospital staff, and health workers of HC in the district. HC may request additional budget from DHO for urgent needs, though most of the time DHO may not grant additional funding to the requests.

*Figure 61: Less than 20 percent DHO received financial supports from PHO*

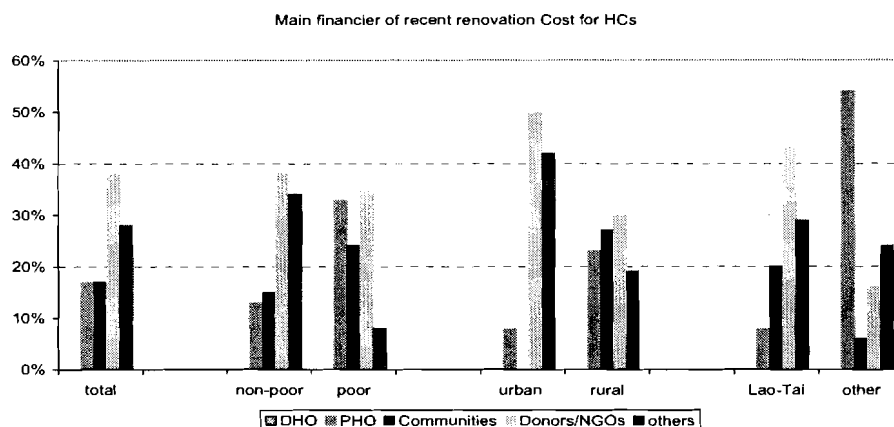


Data Source: PETS.

**Health centers often rely on local support.** Almost two out of five health centers surveyed reported donors and NGOs were the main financiers of their recent renovations (Figure 62). Overall, 30 percent of health centers receive contributions of money and labor from the villages and communities, often for construction and renovation of health centers. In urban areas, this ratio is about 15 percent; while in rural areas, this ratio is about 35 percent (Figure 63). About one out of three HCs in non-poor areas have plots of land for farming; while this ratio is over one out of two in poor areas. However, healthcare facilities in less well-off areas are less able to collect fees from users as a

higher percentage of their patients are eligible to exemptions and donors and NGOs tend to be less active there.

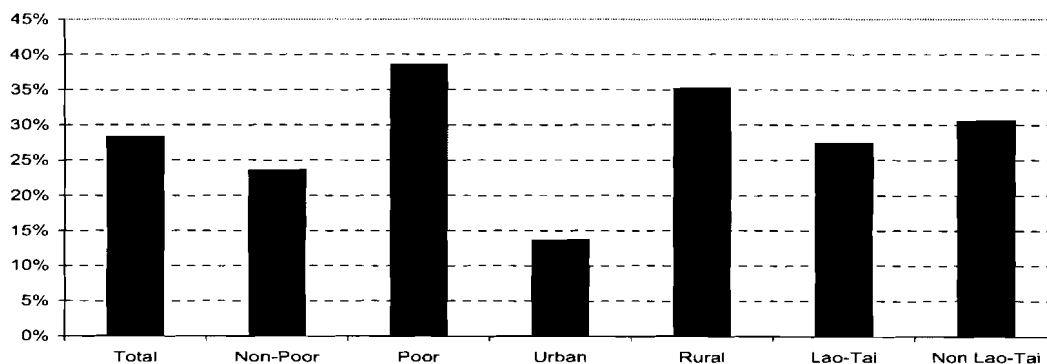
*Figure 62: Donors and NGOs are the main financiers of renovation costs for HC.*



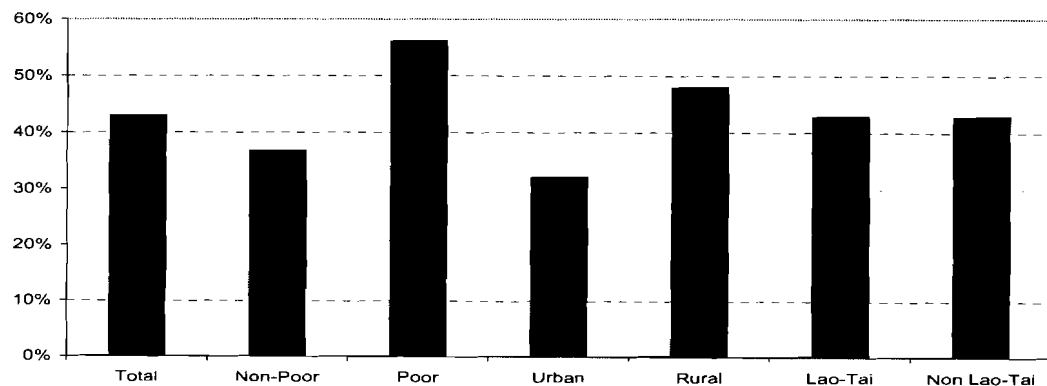
Data source: PETS.

*Figure 63: Health centers in poor, rural, or non Lao-Tai areas are more likely to rely on off-budget funding.*

% of HCs received money gifts or labor contribution from villages served by the HC in 2004-05



% of HCs have plot of land for farming



Data source: PETS.

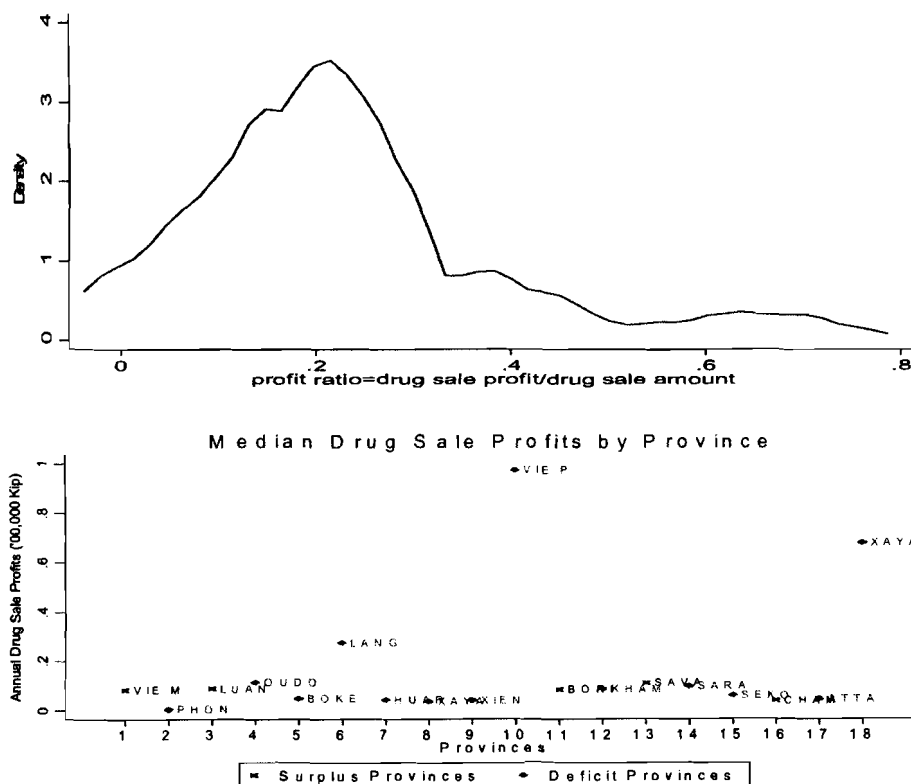


**Revolving Drug Funds are an important source of revenue for health centers.** These funds supplement their operating costs for office supplies, transportation, and utility costs (Box 7). Guidelines stipulate that health centers can earn a 25 percent margin of the retail price over the purchase price, even though there are no clear regularities. While PETS indicates that most health centers have adopted policy, RDFs appear to have different profit ratios (Figure 64). Drug sale profits varied across provinces – health centers in Vientiane province had almost Kip100,000 profits from selling drugs between October 2004 and September 2005, while health centers in 15 out of 18 provinces had less than Kip 20,000.

#### Box 7: Revolving Drug Funds

The RDF system was begun in the 1990s as regional pilot projects in conjunction with community health programs; they were supported by non-governmental, bilateral and multilateral development assistance. A national drug policy was approved in 1993 to improve access to essential drugs and to attain more rational utilization of these drugs. A user fee was introduced in 1995 as a way to recover costs for the health sector. According to PETS, in 2005, more than 95 percent of the health centers had RDF. Almost 60 percent of RDFs in health centers were established after 2001. RDFs at the frontline health facilities have become one of the basic drug supply routes. Although RDFs are supposed to be used only to replenish drugs, PETS indicates that profits from drug sales are being spent on administrative costs, outreach activities, transportation and other cost heads of health centers. One concern is that such revenues create an incentive for health centers to over-prescribe antibiotic and injection.

Figure 64: RDF profit ratios cluster around 25 percent, but they differ across provinces.



Data Source: PETS.

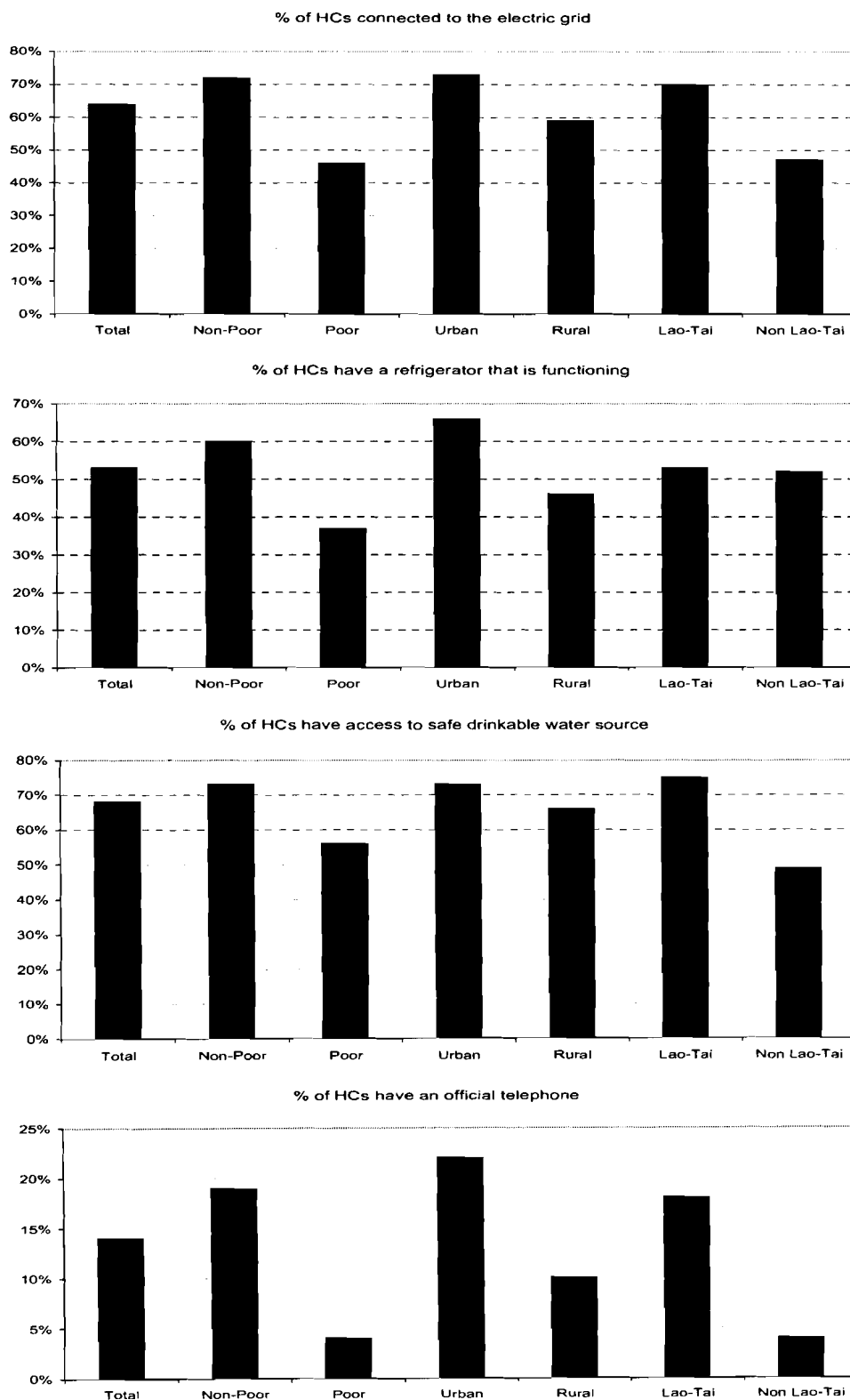
**RDFs are managed differently in some districts and provinces.** The DHO or PHO determines purchasing, financial accounting, and management of inventory of RDFs in health centers. There is no standardized financial reporting system in place. For example, health centers in Vientiane Municipality have almost an exclusive right to purchase their own drug supply directly from private pharmaceutical companies. In Luang Prabang and Champsasak, health centers usually obtain drug supplies from DHO, as they do not have the autonomy to procure drugs independently. Only one out of three health centers has a separate bank account for RDFs. One third of health centers experienced in-stock drug shortage in 2004-05. The longest period for which a drug shortage lasted was about two weeks. The occasional shortage of drugs more often occurs in health centers that have less autonomy.

### **Operating funds and health center quality**

**Health centers have to rely on multiple sources to cover operational costs as funds from DHO are limited.** While the DHO are the principle source of salary payments for health workers, financial support of operational costs to the health center is inadequate. Requests from HC to DHO for cash to fund recurrent costs are typically rejected. Although health centers might receive free drugs, offer transportation at no charge, and donated equipment from DHO, most HC rely on multiple revenue sources, including government, donors, NGOs, communities, and patients.

**Because of a lack of operating funds, most healthcare centers in Lao PDR are not well-equipped.** This is especially true in less well-off areas. Although each province has a provincial or regional hospital and each district has at least one district hospital and an average of six health centers, most health centers are public and more than 10 years old. Due to insufficient funds, reconstruction or renovation of facilities is rare. Health centers are open for business eight hours a day Monday through Friday; some are also open on weekends. Closure for non-official reasons is rare. However, if closure does happen, the health center will report it to DHO. Most health centers take patients outside of regular hours. Some health workers see patients in their homes or in patients' homes. Since equipment and facilities are inadequate and staff knowledge is limited, health centers often have to refer patients to district or provincial hospitals for laboratory tests. Only 14 percent of health centers have an official telephone; 30 percent have a laboratory. Health centers in non-poor, urban, and Lao-Tai areas are relatively better equipped than those in poor, rural, and non Lao-Tai areas (Figure 65). They are more likely to have an electric grid, access to safe drinking water, a functioning refrigerator, and an official telephone.

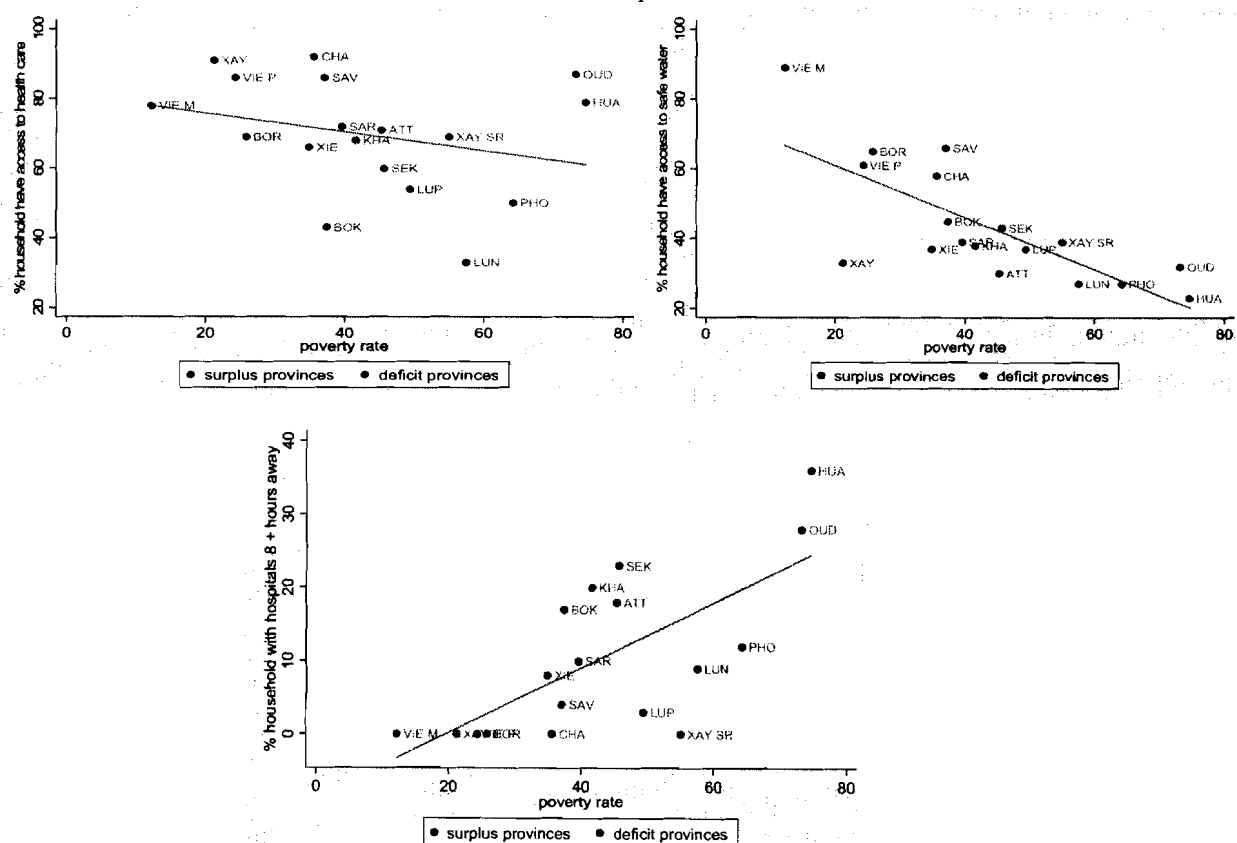
*Figure 65: Health centers in non-poor, urban, and Lao-Tai areas are better equipped than those in poor, rural, and non Lao-Tai areas.*



Data source: PETS.

Poor people have less access to healthcare, to safe water, and to hospitals within distance (Figure 66).<sup>11</sup> The non-poor use more and better public health facilities than the poor, as out-of-pocket expenditures is a serious constraint for poor people to seek health care. Poor people are much more likely to rely on self-healing or self-medication when they are sick compared with the non-poor. There are two reasons: one the poor cannot afford to pay for health services; second, the poor do not think the quality of care they can receive is worth paying for (unskilled health workers, unavailability of medical equipments, etc.). Although their level of household consumption is low, the poor spend an even lower share on health compared to that of the non-poor. To extend the comparison, people in priority districts spend an even lower share on their health compared with people in non-priority districts; and non Lao-Tai people spend a lower share on health compared with Lao-Tai people (Figure 67). The richest quintile captures twice as much public subsidy for health services as the poorest quintile. As in many other countries, this imbalance leads to the de facto pro-rich allocation of public health spending.

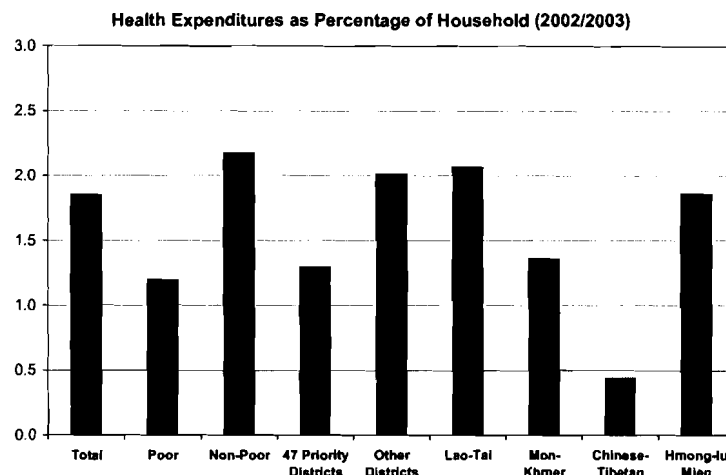
Figure 66: The poor have less access to health care, less access to safe water, and less access to local hospitals.



Data source: World Bank (2004).

<sup>11</sup> Access to health care is defined as access to skilled medical personnel such as medical practitioners, trained nurses, and community health workers at a dispensary. Access to safe water is defined as access to piped water or protected wells.

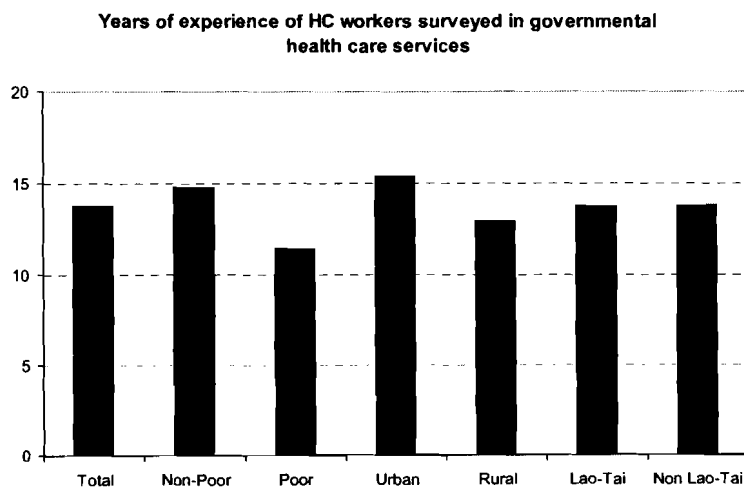
*Figure 67: People in less well-off areas spend a lower share of household consumption on health although their household consumption is already low.*



Data source: LECS 2002/03.

**Health service that poor people have access to is of lower quality.** Health workers in poor or rural areas are less experienced (Figure 68). Health workers receive training from the PHO and DHO two to three times a year on average, but only once a year in priority districts. Health workers in less well-off areas may have less incentive to go to HC working because of the unpleasant environment and inadequate facilities. HC in less well-off areas are more likely to face severe funding constraints, which limit their village outreach activities and health educational programs.

*Figure 68: HC health workers in poor rural areas are less experienced.*



Data source: PETS.

## Accountability

**Community participation may help enhance accountability, but inequitable distribution of resources remains a key concern.** The short route from client to provider in the health sector is blunted by asymmetries of information and conflicts of interest (World Bank 2003). Getting highly transaction-intensive and discretionary individual-oriented clinical services to poor people is most challenging. To influence quality, poor clients should have greater power—through third-party payments, information, and greater oversight of health workers and facilities. A variety of market failures—disease related externalities and fragmented insurance markets—and concerns for equity suggest public intervention is necessary in financing health and nutrition services. Poor people lack the money for market transactions, but still often need to pay for health service directly. Insurance market failures, asymmetries of knowledge, and conflicts of interest mean that governments need to invest in purchasing key services to protect poor households and foster a pro-poor professional ethos.

**To effectively use public health resources, it is important to improve outreach services and community and family-oriented services.** Policymakers need to be accountable for health outcomes—which means greater investment in monitoring and evaluation mechanisms that capture disparities in health (World Bank 2003).

- Population-oriented outreach services—standardized services that can include vector control, immunization, or vitamin A supplementation—are easier for policymakers to monitor (World Bank 2003). Even governments with limited capacity can provide these services—or write contracts with public or private entities to provide them.
- Community and family-oriented services that support self-care—such as information and social support for promoting breastfeeding or safe sex—are often well placed for community and civil society organizations and commercial networks to provide services close to poor households. Governments can establish partnerships and provide information and targeted subsidies.

## Conclusions

**Health outcomes in Lao PDR have been improving, but they still lag behind most East Asian countries.** People who have the best access to quality care are those who can afford it most. Besides income, wide disparities also exist based on geography and ethnicity. Although health workers' job morale is high and absenteeism is low, insufficiency of resources and inequitable allocation between capital and recurrent spending are key constraints of health service delivery. Health workers' salary level is low, and delay in payment is frequent. Maintenance at health centers is inadequate. Public health spending tilts toward the central level. Health facilities rely on contributions from donors and their communities and from Revolving Drug Funds to cover their operating costs, which widens disparities between well-off areas and less well-off areas.

Poor people suffer worse health service as they have limited access to health facilities with reasonable qualities and low capacity to pay.

**Little evidence suggests that salary leakages from the districts to health facilities are a major concern in Lao PDR.** The same is true of absenteeism and ghost health workers. To achieve health MDGs and delivery better health service to poor people, it is important for the government to increase overall public health resources, raise the share of recurrent expenditures, increase the resources devoted to front-line services in rural areas, as well as to streamline and harmonize the expenditure management.

## FINDINGS AND RECOMMENDATIONS

*PETS provides useful information on financial flows at the subnational levels and on characteristics of frontline education and health services. The survey results provide support that leakage of salary payments between districts and facilities is small; ghost-workers and absenteeism by teachers/health workers are rare. There is also high job satisfaction among teachers/health workers, and active participation by parents/patients and community at the frontline level. All of these factors may contribute to the reasonable education and health outcomes in Lao PDR, particularly since it operates under tight fiscal resources. The survey results, however, indicate that insufficient resources, inefficient and inequitable allocation of funds, weak public financial management and local capacity have a negative impact on service delivery, particularly to poor people in less well-off areas.*

*Strengthening financial management to make effective use of limited budget resources is important for improving service delivery. So is the efficient allocation of resources for capital and recurrent expenditures, implementation of the new Budget Law, and improving the effectiveness of donor aid. Along with the recent Lao PDR Public Expenditure Review, the PETS results suggest the following as important steps in bolstering the Public Expenditure Management Strengthening Program (PEMSP) reform agenda: aligning subnational spending programs with the national education and health goal; allocating adequate resources for basic services across all localities; and improving the budget process to ensure effective use of public resources.*

*This pilot PETS succeeded in making a first attempt in documenting the characteristics of frontline services, tracking salary payments from district to facility, correlating performance indicators with service delivery, and recommending policies to strengthen public expenditure management and service delivery. With improvements in local capacity and survey techniques, future PETS reports may provide more accurate information on financial flows and frontline services, and increase the scope and depth of analysis on the tracking of public expenditures.*

*This chapter: (1) summarizes the findings of PETS; (2) reviews the financial management system; (3) provides policy recommendations on strengthening Public Expenditure Management Strengthening Program; and (4) presents suggestions for future PETS.*



## **Main findings of PETS**

**This PETS provides Lao PDR with information on financial and human resources of the education and health sectors at the provincial, district, and facility levels.** It is the first to track salary payments from districts to facilities by comparing salary records of individual teachers and health workers.

**The survey results indicate some positive points:** (1) the evidence does not suggest that leakage of salary payment from district to facilities is a big problem; (2) ghost-workers and absenteeism are not a significant constraint to education and health service delivery; (3) teachers and health workers report high job satisfaction despite low salaries and delays in payment; and (4) parents/patients and communities actively participate at the frontline level. These factors contribute to reasonable outcomes and improvements in education and health service delivery in Lao PDR over the past few years.

**However, the survey results show three major constraints in a highly decentralized Lao system wrapped in a weak PFM framework:** (1) insufficient resources; (2) inefficient and inequitable allocation of funds; and (3) weak public financial management and low capacity at the subnational levels.

- Shortage of funds is the most common problem faced by the education and health systems. Lao PDR's public expenditures for education and health are low compared with other low income countries. Nine out of 10 schools and health centers have to rely on off-budget resources, which makes the disparity in service delivery even larger.
- Limited public spending on education and health is disproportionately allocated to capital expenditures and diverted away from the people who need it most. A mismatch between capital and recurrent spending reduces overall efficiency of service. Coordination between the central and sub-national levels is inadequate. Public spending benefits more of the non-poor than the poor. Expanding services to reach poor people requires better targeting of public expenditures.
- Budget planning is weak and revenue forecasts are unrealistic. Finance and planning functions are fragmented at the central and subnational levels; planning receives short shrift and is compressed into a comparatively short period of time. As a result, planning seems irrelevant and budget execution suffers because of it. This cycle perpetuates itself. Higher transaction costs are one outcome of an inefficient system that can ill afford it and whose limited resources for education and health are already stretched thin. Capacity at the subnational level needs to be strengthened. Accuracy of record keeping is often lacking, knowledge of accounting and revenue/expenditure tracking by staff members need to be improved.

**Due to these constraints:** (1) Money for human resources and equipment is in shortage. Schools/health centers in less well-off areas have less experienced teachers/health workers; there is also a severe shortage of teaching materials/ medical equipments. Furthermore, multi-grade classes are more common; so are longer commutes to education and health facilities. (2) Salaries are low for teachers and health workers; payment delays are frequent and long. Differences in allowance and living costs both work to the advantage of teachers/health workers in less well-off areas. That's because teachers/health workers in less well-off areas receive higher allowances for working there and the cost of living is less. In one sense that puts them at a competitive advantage with their counterparts in well-off areas. However, teachers/health workers in less well-off areas are more likely to experience delays in the payment of their salaries and the delays tend to be longer. Many teachers/health workers have to hold multiple jobs (mainly in agriculture) to pay their bills. (3) Schools/health centers must rely on off-budget resources to cover their routine operating expenses. Schools/ health centers in less well-off areas have it even worse. That is because their local communities and parents/patients are unable to make up the shortfall. Donors and NGOs are often less active in these areas.

## **Finance Management**

**Strengthening financial management to make effective use of limited resources is critical for improving service delivery.** This session focuses on: (1) reviewing the PFM system in the decentralized central-local framework; (2) offering suggestions on implementing the new Budget Law to improve the PFM system; and (3) harmonizing external financial management to improve the effectiveness of donor aid.

### **Public Finance Management**

**The central government of Lao PDR exerts little control over provincial finance departments.** No systems link provincial finance departments with the Ministry of Finance. Lao PDR is one of the most decentralized countries in the world. Provincial authorities have the power to transfer funds within and across expenditure items; they also have the authority to determine spending at the sectoral level. National priority sectors, such as education and health, do not always get the same funding priority at the subnational levels that they are supposed to. As a result, these sectors often face tight resources constraints.

**Because of the weak systems, a lack of enforcement and of internal controls, the fiscal transfer process is unpredictable and erratic.** Provinces whose revenues exceed expenditures are mandated to transfer their surpluses to the central government. The central government in turn is mandated to transfer funds to provinces whose revenues fall short of expenditures. And yet, projected transfers from surplus provinces often fall short of actual transfers. No institutional mechanism exists in the national budget process for targeting priority districts (Box 8). Furthermore, it is not possible to determine the cause for these shortfalls because there is no revenue monitoring system at the central level. In addition, unpredictable transfers undermine the effectiveness of limited public resources.

### *Box 8: Public Expenditures in Priority Districts*

No institutional mechanism exists in the national budget for targeting priority districts. The government channels resources to priority districts: (a) favoring projects in these districts at the provincial level; and (b) directing donor funding to these areas. However, the central government has set no minimum allocations for priority districts. And yet, an analysis of public expenditures in the priority districts is not possible because of the poor quality of local information systems. The current system allows the collection and analysis of sectoral expenditures at the provincial level, but not at the district level. In the next few years, it will be necessary to enhance the monitoring of district expenditures to assess the effectiveness of the government's anti-poverty strategy. Provincial line agencies should start screening their expenditures by district to better target their poverty reduction programs. The new Budget Law, which is under preparation, will set binding minimum allocations for the provinces to spend on priority sectors. It remains unclear whether the new budget will make it easier to monitor district expenditures.

*Source:* World Bank (2006b).

**The current decentralized public finance management practices along with inadequate accountability and controls has led to:** (i) an uneven application of national policies; (ii) an accumulation of arrears on goods and services; (iii) a funds shortfall for deficit provinces; and (iv) an inability of the central government to ensure execution of the budget, as approved by the National Assembly. Strengthening public financial management is key to improving primary education and health service delivery.

### **Budget Law Implementation**

**The National Assembly passed a new organic Budget Law in November 2006.** The President signed it into Law in February 2007. The new Budget Law aims to fundamentally transform intergovernmental fiscal relations. It will centralize the Treasury, Tax, and the Customs Departments and develop a new revenue sharing framework that will better align policies with the budget. The changes mandated by the new Budget Law aim to significantly improve the planning, execution and reporting of public finances. Box 9 highlights the implications of the new Budget Law on intergovernmental fiscal relations.

*Box 9: New Organic Budget Law in Lao PDR—Changes in Intergovernmental Fiscal Relations*

The new organic Budget Law aims to address some of the weaknesses in the current intergovernmental fiscal relations. These deficiencies stem from decentralized management of public finances, inadequate monitoring and controls. In essence, the new Budget Law, together with the Public Expenditure Management Strengthening Program, aims to put in place the fundamentals of a well functioning public finance management system.

The key elements of the new Budget Law are: (i) the centralization of the Treasury Department; (ii) the centralization of the customs and tax departments; and (iii) development of a robust revenue-sharing framework that would align policies with budget allocations. If successful, these new measures will significantly improve intergovernmental fiscal relations and help the government establish greater control over public finances and more clearly align policies with the budget.

Effective implementation of the Budget Law will require significant capacity, continued political commitment, technical assistance, and a well developed and sequenced 3-5 year Budget Law Implementation Plan. This Plan will centralize the three departments and develop the revenue sharing framework. In this regard it will be particularly important to ensure that inter-linkages between these elements of the plan are carefully calibrated. Another important issue is the implementation of the Value Added Tax—currently planned for October 2008. In order for this measure to be successful, close coordination will be required between the tax department, customs department and the Treasury. Particular attention will be needed to ensure that the VAT refund system is properly instituted and tested prior to the introduction of the VAT. Of particular importance is the effective centralization of the Treasury. Without an effective Treasury, all other reform elements may not succeed.

Implementation of the Budget Law has started with the restructuring of the Ministry of Finance via the Prime Ministerial Decree Number 80 of February 28, 2007. In this regard the Minister of Finance has constituted a high level committee within the Ministry of Finance with five subcommittees to oversee implementation of key aspects of Budget Law implementation. These are: (i) preparing the implementation decree for the Budget Law and related guidelines; (ii) devising a framework for introduction of budget norms for some sectors; (iii) developing budget execution report formats consistent with the new Budget Law; and (iv) revising the budget nomenclature. These subcommittees have started functioning. The government is also working on developing a detailed 3-5 years Budget Law implementation plan that looks at each of the main elements of the Budget Law, along with their inter-linkages. This plan is expected to be ready by end-May 2007.

There will be need for significant and untied financial support to government for developing information systems, human resource management skills, and related technical assistance, for which greater harmonization of donor support will be crucial.

**The effective implementation of the Budget Law is critical for improving the public financial management system.** If the Budget Law is implemented effectively and the reform elements proposed under the PEMSP are also in place, then Lao PDR will have a robust and efficient public financial management system: (i) budget allocations will be much better aligned with policies; (ii) government will have the ability to uniformly execute policies throughout the country; and (iii) the central government will be able to ensure that budgeted funds get spent on those items; and (iv) improved reporting and monitoring of budget will be possible. However, implementation of this new law does not imply a sudden increase in resources, but it will improve revenue sharing. In case the Budget Law is not implemented in an orderly manner, there is significant risk that the current system will be in worse shape, due to the additional uncertainty in the intergovernmental fiscal framework. For example, if revenues are centralized before the

national treasury is capable of sending the funds back to the provinces, then service delivery will suffer. The whole reform program may get derailed.

**Therefore it is very important to make sure that the budget law implementation is properly sequenced.** For that to happen, it is important to have: (i) continued political support, (ii) significant implementation capacity and systems development; (iii) coordinated resources; and (iv) proper sequencing of reforms and consideration of the links between revenues and expenditures; and (v) expansion of capacity to mitigate key personnel risks.

## **External Financing Management**

**Misalignment of capital expenditure with recurrent needs is a key constraint of effective resource management.** An issue of importance is that external loans and grants that Lao PDR received from overseas development assistance (ODA) in the form of project support finance a significant amount of capital spending. In FY2004/05 project loans and grants amounted to 28.0 percent of total expenditures, or 74.8 percent of the total public investment plan (PIP); budget support amounted to 9.8 percent of total expenditures. Between 2002/03 and 2004/05, overall expenditure has been tightly squeezed: PIP went down, donor funding decreased, and non-wage recurrent started to increase slowly. It is important to better align capital expenditures with recurrent needs.

**Information on grant aid is sketchy.** Nearly all project loans and grants are executed outside the general budget. The money comes through special accounts operated by project units that follow donor procurement and financial management practices. In-kind support by development partners is not effectively recorded by the Ministry of Finance or the recipient agency because the financial flows take place largely outside Lao PDR. As grant aid is in general not reported to the system, it is difficult to access the total magnitude and composition of assistance off-budget. However, donors do show such support as received by Lao PDR.

**The effectiveness of donor assistance is often compromised by an inaccurate match between the donor's wish and the government's need.** It is important to strengthen the capacity of public finance management at the sector level to effectively execute donor funding in the system. To improve the effectiveness of donor support, the government has recently welcomed steps to establish multi-donor trust fund type of arrangements. The Avian Influenza trust fund was established. There are plans to establish another multi-donor trust fund arrangement for the public finance management strengthening program, including implementation of the Budget Law.

## **Bolster Public Expenditure Management Strengthening Program**

**To improve public finance management, the Lao government implemented the Public Expenditure Management Strengthening Program (PEMSP) in September**

**2005.** The PEMSP has six components: (i) fiscal planning and budget preparation; (ii) budget execution, accounting and financial reporting; (iii) local government financial management; (iv) financial legislation and regulatory framework; and (v) capacity building. Tension between Ministry of Finance and sector ministries often comes from a difference in perception: the budgets “needs” of the sector ministries and the inability of the MoF to finance these “needs.” MoF often reverts to the previous year’s budget and makes an incremental increase, which is not in line with the sector budget proposal.

**To bolster the PEMSP reform agenda for basic education and health services, the findings of this report and that of the recently completed Public Expenditure Review (World Bank 2006) suggest that it is important to closely align subnational spending programs with the national education and health goals; to allocate adequate resources for basic services across all localities; and to improve budget process to ensure effective use of public resources.** This is also important for ensuring effective fiscal arrangements for revenue generated by the hydro power project Nam Theun 2. From 2009 onwards, these revenues will go to funding basic social services. In this connection, there are three priorities:

***First, subnational spending programs should be aligned with the national education and health goals articulated in the NSEDP.*** The following policies could support this principle:

- The annual budget process should be started earlier in the year to ensure sufficient time for input from districts and provinces. This could provide the space for frontline services to be integrated into a bottom-up budget process.
- Broad substantive guidelines and norms for expenditures could help the provinces and districts allocate funds to those areas where the government has set clear national priorities. While different needs, conditions, and institutions will mean some variation among localities, a set of uniform procedures could inform sub-national allocations at the beginning of the budget year. These procedures could also improve transparency and limit ad hoc cash management.

***Second, subnational authorities should have adequate resources for basic services across all localities.*** The following policies could support this principle:

- GOL could more appropriately allocate public resources to the education and health sectors to balance the need for capital investment and recurrent spending. An increase in resources to cover wages and operating costs could help make better use of existing and new investments and ultimately deliver better services.
- GOL could raise compensation for teachers and health workers and reduce payment delays. There could be incentives for teachers and health workers to work in remote areas.

- Tie salary increases for teachers and health workers to a management policy that covers recruitment, training, and performance accountability.
- Community-based programs in less well-off areas could attract and retain non-Lao-Tai students into basic education, and ensure basic maternal and child health care.

**Third, the budget process should ensure the effective use of public resources.** The following policies could support this principle:

- Reassert the authority of the central treasury over provincial and district treasuries to capture any off-budget revenues at the subnational level. Put the roll-out of the Government Financial Information System on a fast track to the provinces and districts.
- Standardize the reporting formats and payment procedures at the subnational level and base them on the new budget execution reports and the Chart of Accounts. Require the provinces to publish their budgets and end-year accounts and post them on public notice boards.
- Strengthen the education and health management information systems at the subnational levels by giving them effective planning and monitoring tools.
- Accelerate capacity building in financial management at the subnational level by pairing a needs assessment with an implementation strategy.

## **Steps forwards**

**A PETS offers a technique for tracking public expenditures and their impact on service.** This pilot Lao PETS succeeded in obtaining rich and valuable information in most areas, such as facility characteristics, financial flows, and accountability arrangements, thanks to expert data collection by the NSC and the enumerators. Thanks also go to the Ministries who ably assisted in the preparation of the questionnaire.

**Building local capacity is important for improving public financial management and service delivery in Lao PDR.** It is also important for conducting an effective survey. It may be helpful to clarify upfront in the survey what budget items the questionnaire covers, as these items may be different from what the respondents envision. Improving survey design to cross-check questions/data and to strengthen interim survey data quality control are also technically advisable.

**With the strengthening of local capacity and improvement of survey design and techniques, future PETS should aim at providing broader and deeper information and analysis on public expenditures tracking and service delivery.**

- To better track public expenditures and understand the constraints that hinder service delivery, for the next PETS, it would be helpful to have the following information more accurately:
  - Expenditures and revenues—How much education/health budget resources are allocated from the center/province/district to province/district/facility? For what purpose? When? How much of it actually reaches its intended audience? When do they receive it and how do they use these resources? What share of budget and off-budget resources does it represent out of total revenues and expenditures?
  - Budget process and financial management—When are schools/DEB/PES and HC/DFO/PFO supposed to submit budget proposals to their respective upper layers? Do they submit them on time? What are the procedures? How much do they propose? How much is approved and allocated? How much do they actually spend, for what? How do funds flow within and between the layers of the MoF and the line ministries MoE/MoH?
- To strengthen the analysis at the frontline level, it would be useful to have the following information more accurately:
  - What is the approximate share of total resources that schools or health centers receive from each source, namely the central budget, provincial/district authorities, DEB, DFO, donors, NGOs, communities, and parents/patients?
  - How did they spend these resources? Does this match the intended purpose?
  - What is the timing of the inflow of resources and the outflow of expenditures? Are there gaps between the two? If so, how are they filled and by what source?
  - What resources are spent most efficiently? Under what conditions and where? What contributes to that efficiency? What bottlenecks do provinces/districts/facilities face?
  - If a brief user survey can be included, what is the parents'/students' and patients' perception of the quality of service they receive? Does the service match the potential demand?
- Given the frequent and common delays in payment of salaries to teachers and health workers, it would be useful to have the following information more accurately:



- Do teachers get paid in full when there is a delay? Are salary delays a result of limited resources? If so, has it become standard procedure to wait for next year's budget to satisfy the delayed salary payments incurred this year?
- If total resources are insufficient for operating costs and salaries, would salaries get a higher priority over funds originally assigned to operating costs?
- If resources are not enough to pay all teachers'/health workers' salaries in full, did some teachers/health workers get paid in full on time while some did not get anything? Did all get paid a certain percentage of their salaries on time? Or did they all have to wait before resources became available to pay them in full? How did this affect the amount of arrears and the length of the delay?

## Conclusions

**Primary education and health service in Lao PDR have improved over the last decade with reasonable outcomes.** The PETS results suggests that salary leakages from the district to facility levels are low, ghost-workers and absenteeism are not big concerns, the morale of teachers and health workers is high, and parent/patients and community participation is active.

**However, insufficient resources and capacity, especially at the local level, inefficient and inequitable allocation of funds, and weak public financial management undermines education and health services, particularly for poor people in less well-off areas.** Teachers' and health workers' salaries are not only low but these workers also frequently experience delays in payment. Schools and health centers face an acute shortage of funds to cover their operating costs. They have to rely on off-budget resources. Donors' aid does not always match local needs.

**To improve education and health service delivery, it is important to allocate more resources to these national priority sectors and strengthen financial management.** Effectively implementing the new Budget Law effectively is a high priority. That single step should help to transform the intergovernmental fiscal relations and align policy with budgets. It should also bolster the Public Expenditure Management Strengthening Program reform agenda.

**This pilot PETS succeeded in providing rich and valuable information, such as documenting frontline service characteristics, financial flows and accountability arrangements.** It was the first attempt to track salary payments to teachers and health workers from the districts to the facilities. The findings of this PETS serve as useful baselines for future studies. With improvements in local capacity and survey techniques, future PETS will provide broader and deeper information and analysis on the tracking of public expenditures and the delivery of services.

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## MAP SECTION



100°E 105°E 110°E 115°E

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